PRINCIPLES AND PRACTICE OF BOOK-KEEPING AND ACCOUNTS

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BY

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PREFACE

THE primary object of this book is to assist students who are preparing for professional examinations in book-keeping and accountancy.

An attempt has, nevertheless, been made to treat the subject from a purely practical point of view, and it is hoped that the general utility of the volume will be increased by the many worked examples included, and by the information upon important points of commercial law and procedure which have been incorporated in the text.

Recognising that one of the chief factors of success at examinations in book-keeping and accountancy is the ability to work examples quickly, the author has included at the end of each chapter a number of carefully graded exercises, in the hope that these will enable examination candidates to obtain that constant practice which is so necessary for speed and accuracy. Skeleton answers to the arithmetical questions will be found at the end of the book.

Most of these exercises have been selected from examination papers set by the Institute of Chartered Accountants, the Society of Incorporated Accountants and Auditors, the Association of Certified and Corporate Accountants, the Chartered Institute of Secretaries, the London Chamber of Commerce, the Royal Society of Arts, and other examining bodies, to whom acknowledgment is due and is here accorded.

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B. G. V.

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CHAPTER I

THEORETICAL BOOK-KEEPING

The Importance of Book-keeping.

The need for a system by which man might keep a record of his business transactions with his fellow-men was felt early in the history of civilisation, and many and varied have been the methods used for this purpose. What we now know as "Book-keeping," however, had its beginnings at a comparatively recent date, and the system of recording business transactions in books of account has passed through many phases since its institution. With the development of commerce it has attained a position of great importance; indeed it can truly be said that book-keeping has become the foundation on which the whole fabric of modern commerce rests, for without its use business transactions could be carried out only in their most elementary form, and the development of the modern credit system, with its advantages of convenience, economy and general utility, would have been impossible.

Book-keeping is essentially a practical subject, the purpose of which is to aid the conduct of business transactions, i.e., book-keeping was made for business and not business for book-keeping. This is an extremely important fact, and the reader must realise from the very commencement that although the fundamental principles of book-keeping remain the same, the methods of applying these principles in practice must be sufficiently elastic to be capable of application to any particular type of business.

Definition of Book-keeping.

Definitions of "Book-keeping" are numerous, but it is difficult to explain in a few words the exact meaning of a term which has such a wide and varied significance.

A modern English dictionary defines "Book-keeping" as "the art of recording pecuniary or business transactions in a regular and systematic manner," but the term as understood by the practical business man involves much more than the simple recording of transactions in a systematic manner; it pre-supposes that such record shall be in a permanent form, and that the details

concerning the transactions shall be so arranged that the monetary aspect of :—

(*a*) Each separate transaction,
(*b*) Each group of similar transactions, and
(*c*) The whole of the transactions

entered into during a given period, may be ascertained with the minimum of trouble and delay.

In order to accomplish this result, it has been found necessary to enter the transactions in specially ruled books, which facilitate the classification and aggregation of similar items, without impeding reference to any particular entry.

These books will be considered, in detail, at a later stage, but it must first be explained that just as there are two parties to every agreement, so there are, to every transaction, two separate aspects, *both* of which must be recorded in order to obtain the financial information which practical business demands. For example, if *A* sells a fountain pen to *B* for £1 and *B* pays the £1 cash immediately :—

A must show in his books :—

(*a*) That he has pens to the value of £1 *less* than he had before ; and
(*b*) That he has £1 *more* in cash than previously.

B must show in his books :—

(*a*) That he has pens to the value of £1 *more* than he had before ; and
(*b*) That he has £1 *less* in cash than previously.

Thus it is seen that every transaction has two aspects in *each* party's books.

This simple example furnishes the key to a fundamental principle, which must never be lost sight of by the reader ; it is the basis of the universally adopted system known as Double Entry Book-keeping.

The "Double Entry" System.

The system of "Double Entry" book-keeping, which is believed to have originated with the Venetian merchants of the fifteenth century, is the only system fulfilling this requirement of recording the twofold aspect of every transaction. The result of applying this principle in practice may be usefully summarised in the axiom : "Every debit requires a credit and *vice versa.*" These words express, in technical language, the fact that in recording a transaction in accordance with the principles of Double Entry book-keeping—

(1) The receiver is charged or *debited* with the pecuniary value of whatever he (or it) receives ; while
(2) The giver is *credited* with the same amount, this being the value of what he (or it) gives.

As will be seen later the main book of account, termed the Ledger, is composed of pages (or "folios") divided vertically into two parts, each part containing a cash column; the left-hand side is called the "debit" side, while the right-hand side is termed the "credit" side. An item which is entered on the left-hand (debit) side is accordingly said to be debited, and makes that account a debtor as far as the item debited is concerned. Conversely an item entered on the right-hand (credit) side is said to be credited, and makes that account a creditor as far as the item credited is concerned.

This statement may be illustrated by a further consideration of the simple transaction previously referred to, wherein *A* sells a fountain pen to *B* for £1 and *B* pays the £1 cash immediately. In this case *A's cash box* receives a pound note, and his *stock of goods* is reduced by one pen worth £1, while *B's cash box* gives a pound note, and his *stock of goods* is increased by one pen worth £1. The entries necessary to record this transaction in each party's books are, therefore, as follows :—

(1) *In the books of A.—Debit* Cash Account (the receiving account) with £1 and *Credit* Goods Account * (the giving account) with £1.

(2) *In the books of B.—Debit* Goods Account * (the receiving account) with £1 and *Credit* Cash Account (the giving account) with £1.

It will be clear from the above example that every transaction involves the making of *two* entries (a complete debit and credit) *in each party's books.*

Business transactions involving the purchase and sale of goods may be classified as either (*a*) Cash Transactions, or (*b*) Credit Transactions. In the case of a cash transaction, the buyer pays cash immediately for the goods that he has bought (as in the foregoing example of a sale from *A* to *B*). In the case of a credit transaction, however, *settlement in cash is deferred to some future date,* while in the meantime it is necessary for the parties to the transaction to record in their respective books the relationship of debtor and creditor that exists between them. Thus, if in the previous example *B* had purchased the pen on credit, and later on had paid *A* £1 in cash in settlement of his debt, the two transactions (the purchase of the pen and the discharge of the debt) would be recorded in the books of both parties as follows :—

(i) In the Books of A :—

(*a*) *When making the sale.—Debit B's* Account (the receiving account) with £1 and *Credit* Goods Account * (the giving account) with £1.

* As shown on page 28, a Goods Account is rarely used in practice, but it has been used here in order to indicate the theoretical application of the Goods (Real) Account.

(b) *When receiving cash in settlement of the debt.—Debit* Cash Account (the receiving account) with £1 and *Credit B's* Account (the giving account) with £1.

(ii) IN THE BOOKS OF B :—

(a) *When making the purchase.—Debit* Goods Account * (the receiving account) with £1 and *Credit A's* Account (the giving account) with £1.

(b) *When paying his debt in cash.—Debit A's* Account (the receiving account) with £1 and *Credit* Cash Account (the giving account) with £1.

The debit and credit aspects of each transaction must always be considered alone, *without reference to anything that has happened previously*. Thus the sale or purchase of goods on credit is one transaction requiring a debit entry and a credit entry in each party's books, while the settlement of the account for such goods is, for book-keeping purposes, a *separate transaction* which also necessitates both a debit entry and a credit entry in each party's books.

It should be observed that when a trader buys or sells goods *for cash* (as in the first example above), he does not open an account in the name of the supplier or customer, for the entries therein would immediately offset each other, and it would be a time-wasting procedure to record them.

The Books Required for Recording Transactions.

Theoretically, the one essential book of account is the LEDGER. The double entry is completed therein, and consequently it is, *in theory*, possible to carry out a complete system of book-keeping by using this one book. In actual business, however, such a method has been found to be totally impracticable, as you will readily appreciate later in your reading. Therefore, in the simplest form of book-keeping at least two books are used, viz.,

(a) A Journal, and (b) A Ledger.

The name of the former comes from the French word *journal*, which means a diary, day-book, or log-book. In it is written a complete daily list of the trader's transactions, entered in the order in which they occur.

The operation of recording transactions in a Journal, or *journalising*, is undertaken in order to obtain a complete and reliable chronological record of the transactions. The items are arranged so as to show clearly the account to be debited or

* As shown on page 28 a Goods Account is rarely used in practice, but it has been used here in order to indicate the theoretical application of the Goods (Real) Account.

credited, as the case may be, thus facilitating the transfer, or *posting*, of the items to appropriate accounts in the *Ledger.* The latter book contains a permanent record, in a classified form, of all the transactions of the trader.

It will be shown later that the Journal may be, and often is, sub-divided into a number of subsidiary books which, for convenience, are described by other names, and have certain specialised functions.

Similarly, the Ledger is almost always divided into a number of separate books, each of which is allocated to a particular class of transaction. For example, one ledger may contain the accounts of all persons from whom a trader purchases goods, i.e., his creditors, and another the accounts of all persons to whom he sells goods, i.e., his debtors. These sub-divisions of the two main books are made, however, simply for convenience or for economy of time and effort; for the effective presentation and record of the transactions of a business only two books of account are actually necessary, viz. :—

(1) THE JOURNAL, a subsidiary book in which are made the initial or "prime" entries *in chronological order*; and

(2) THE LEDGER, in which are recorded the transactions *after classification* into suitable groups, e.g., those affecting cash, or goods, or persons.

Classification of Transactions.

The classification of entries, or the collection of transactions of a similar nature, into appropriate accounts, demands extreme accuracy on the part of the book-keeper, but provided that a few simple rules are observed, the work presents no difficulties which cannot easily be overcome. Thus, the whole of a trader's transactions with another person are recorded in an account bearing that person's name; whilst his dealings in property and his items of expenditure are entered in accounts headed with the names of such property and class of expenditure respectively. Accounts which stand in the names of persons, firms or companies are called PERSONAL ACCOUNTS; all others are IMPERSONAL ACCOUNTS.

Impersonal Accounts may be further sub-divided into two classes, viz. :—

(1) *Real Accounts*, recording transactions in property and material objects (assets); and

(2) *Nominal Accounts*, recording items of expenditure incurred and income received, losses made and gains effected.

The following list indicates a few of the more usual accounts coming under each heading :—

PERSONAL ACCOUNTS.	IMPERSONAL ACCOUNTS.	
	Real.	*Nominal.*
A. & Co. (a customer).	Land.	Rent.
B. & Co. (a supplier of goods).	Buildings.	Wages.
Mr X. (Capital account).	Machinery.	Discounts.
(The last-named is an account showing the proprietor's personal relations with his business.)	Stock in Trade.	Interest.
	Cash.	Insurance.

The Rules for Debiting and Crediting.

To ensure accurate treatment, it is necessary to bear in mind that each transaction stands alone, and that its twofold aspect must be recognised and recorded entirely on its own merits without regard to any other item. The question as to whether an item has to be entered on the debit or the credit side is one which is apt to present a little difficulty at first, but if it is remembered that the account which "receives" is debited and the account which "gives" is credited no difficulty should be experienced. Thus it may be stated that an account is debited with any value that comes into that account, and is credited with any value that goes out of that account. The following diagram shows the application of this rule to each class of accounts :—

CASH ACCOUNT.		PERSONAL ACCOUNTS.		REAL ACCOUNTS.		NOMINAL ACCOUNTS.	
Debit.	Credit.	Debit.	Credit.	Debit.	Credit.	Debit.	Credit.
Receipts.	Payments.	Receiver.	Giver.	Property received.	Property given.	Expenses and Losses.	Income and Gains.

CASH ACCOUNT.—If any difficulty is experienced in remembering whether cash receipts and payments should be debited or credited in the Cash Account, it should be recollected that receipts from *debtors* are *debited* to Cash, while payments to *creditors* are *credited* to Cash.

PERSONAL ACCOUNTS.—The rule applying to Personal Accounts is quite straightforward. The term "giver" is used as the opposite of "receiver," and not as implying someone who makes a free gift to the business, but in the same sense as the verb in the sentences "*A* gives £1 for a box" and "*B* gives a ton of coal for £2."

REAL ACCOUNTS.—The rule stated in connection with cash receipts and payments applies also to transactions affecting Real Accounts, for the Cash Account is, in fact, a Real Account, and is shown separately in the foregoing diagram because of its importance. When property is acquired, the appropriate Real Account is debited, and when property is disposed of by sale or

otherwise, a credit is required; e.g., If *A* buys two acres of land for £100, and subsequently sells one acre for £50, both transactions being completed immediately by the payment of cash, the entries in *A*'s books would be :—

FIRST TRANSACTION.

Debit Land Account with £100 (Property received); and
Credit Cash Account with £100 (Cash payment).

SECOND TRANSACTION.

Debit Cash Account with £50 (Cash receipt); and
Credit Land Account with £50 (Property "given").

NOMINAL ACCOUNTS.—The rule of debiting losses and expenses and crediting gains and income may seem a contradiction of the general procedure, but if the matter is carefully considered it will be seen that this is not the case. It has already been stated that each transaction must have both a debit and a credit entry; and an example of a nominal account transaction is "Paid wages in cash £50." Obviously cash must be credited, as money has gone out, and equally obviously a debit entry must be made to balance the credit; in other words, the payment out must be charged to some account. Hence an account headed "Wages" is debited with the entry. This can also be considered from another viewpoint; thus Wages Account may be regarded as the combined personal accounts of all the recipients of wages, and so the rule of "debit the receiver" is again exemplified, cash, the giver, being credited. The converse arguments will, of course, apply to the accounts in which income and gains received are credited to various nominal accounts, and cash is debited in respect of the amounts received.

THE JOURNAL

As already explained, the Ledger is, in theory, the only book necessary to record fully all the transactions in accordance with the essential principles of the double entry system of book-keeping. If, however, no other book were kept, there would be no record of all the business transacted in the date order in which it occurred. It is for this reason that the Journal, or book of first entry, is used in addition to the ledger. Thus, the Journal is the "day-by-day" book of the business wherein both aspects of all transactions are recorded in chronological order.

In its usual form, a Journal is divided by vertical lines into five columns in which to enter in respect of each item: (i) the date; (ii) the names of the two ledger accounts affected (the account debited always coming first), with brief details of the transaction (termed the *narration*); (iii) a reference to the pages (or folios) in the ledger to which the entries are *posted*, i.e., transferred; and (iv and v) two cash columns for the debit and credit amounts respectively.

These columns are illustrated in the following specimen ruling, in which is entered a record of the first credit transaction referred to in this chapter (in the books of *A*), the date and ledger folios being assumed.

JOURNAL.

Date.	Names of Accounts affected, with a narration of each transaction.	Ledger Folio.	Debit Column.	Credit Column.
19..			£ s. d.	£ s. d.
Jan. 1	*B's* Account . . . . . *Dr.*	7	1 0 0	
	To Goods Account	10		1 0 0
	Being sale of one fountain pen to B as per Invoice No..			

NOTE.—In practice, the only headings which actually appear are those in the cash columns, and these are contracted from "Debit Column" and "Credit Column" to "Dr." and "Cr." respectively.

Entries in the Journal are arranged and worded so that the ledger-keeper can immediately recognise on which side of the relative ledger account each item is to be entered. For this reason :—

(i) Separate cash columns are provided for the debits and credits.

(ii) The account to be debited is always entered before the account to be credited, the latter being shown on the next succeeding line. The debit entry is followed by the abbreviation "Dr."

(iii) The word "To" is prefixed to the credit entry, which is written slightly more to the right-hand side than the debit entry in order that its position may correspond with that of the credit cash column, wherein the relative amount is entered.

At first sight, these details may not appear of very great importance, but experience has shown that they are of real assistance in facilitating the work of posting to the Ledger, not only in private study and in the examination room, but also in practical work.

The Narration.

The object of the brief summary—technically termed the "Narration"—which follows each entry is to provide a concise yet adequate explanation of the transaction. Its importance cannot be too strongly emphasised, since it gives the reason why the respective accounts are debited and credited, and provides information which will certainly be required if the books are audited, and may be of great value for other purposes years after the entry was made.

The narration must always be included when a journal entry is made, and students should accustom themselves to this essential of practical book-keeping by adding narrations to all journal entries when working exercises or in the examination room. In the former case it promotes thoughtful work, and in the latter, enables the examiner to judge whether the candidate has understood correctly the nature of the transaction in the question. Too much detail is not required; but sufficient information should be given to ensure that reference to it will adequately explain the entry.

The foregoing statements will be further elucidated in the following example by a consideration of a number of transactions of a trader whose books are kept on the double entry system.

EXAMPLE.

TRANSACTIONS OF ALBERT BROWN, TRADING AS "THE RETAIL COAL STORE."

	19..	
(1)	1st January.	Albert Brown commences business as a coal merchant, trading under the name of "The Retail Coal Store," with a capital of £100.
(2)	2nd January.	He buys on credit from the Seafield Colliery Co. 50 tons of coal at 30s. per ton *ex* colliery.
(3)	10th January.	He receives an invoice from the Northern Railway Co. for £31 5s. in respect of the carriage of the coal.
(4)	20th January.	He sells the 50 tons of coal on credit to Alfred Jones at 47s. 6d. per ton.
(5)	30th January.	He pays the railway company's account.
(6)	30th January.	He pays £40 on account to the colliery company.

Write up the books of "The Retail Coal Store" and ascertain its financial position on 31st January.

In this example, there are six distinct transactions to be recorded.

(1) *The commencement of business.*—At the outset, it must be clearly understood that we are concerned only with the transactions of the Retail Coal Store, and not with those of its proprietor. Notwithstanding the fact that Mr Brown is the sole owner of the coal business, his dealings in his private capacity and those of the Retail Coal Store are things quite apart. The business and its proprietor, from a book-keeping point of view, are two distinct entities, and transactions between the business and Mr Brown will be recorded in the latter's personal account in exactly the same way as transactions with the firm's customers are recorded. If Mr Brown purchases coal from the Store for his private use, his account will be debited with the cost thereof; and, similarly, if at the end of a financial period it is found that the business has earned a profit for its proprietor, his account will be credited with the amount of such profit.

If this aspect of the position is clearly grasped, it will not be difficult to understand that on the 1st January the Retail Coal Store starts trading with absolutely nothing, and that when Mr Brown introduces £100 as capital (in effect lending this sum to the business) the entries in the firm's ledger will be—DEBIT Cash Account, because the cash box *receives* the money; and CREDIT Mr Brown's (Capital) Account, because Mr Brown *gives* the money.

(2) *Purchase of coal.*—This transaction results in the transfer of the coal from the Seafield Colliery Co. to the Retail Coal Store. The latter increases its possessions, at the same time incurring a liability to pay the Colliery Company for the coal. Both aspects of this transaction must, of course, be recorded, and the entries will be—DEBIT Coal Account, as the receiver of the coal; and CREDIT the account of the Seafield Colliery Co. (the "giver") in respect of the money due to it for the coal.

(3) *Carriage of the coal.*—The Northern Railway Co. performs the service of transporting coal from the colliery to the local railway depôt, and this service increases the value of the coal by bringing it into closer proximity to potential consumers. It would accordingly not be incorrect to debit Coal Account with the cost of the services rendered by the Railway Co., since that account receives the benefit; but as one of the main objects of book-keeping is to classify expenditure into as many sub-divisions as are necessary to enable the proprietors to ascertain quickly and accurately the total amount of charges under any particular heading, it is usual to open a separate account for such a general class of expenditure as carriage. Therefore all charges under the heading "Carriage" are DEBITED to, i.e., charged against, Carriage Account in the Store's ledger, and the Northern Railway Co.'s personal account CREDITED.

(4) *Sale of coal.*—The stock of coal at the Store's yard is reduced by the sale, and the purchaser receives a corresponding benefit. A. Jones' personal account will, therefore, be DEBITED and the Coal Account CREDITED with the amount charged for the coal.

(5) *Payment to the Railway Company.*—The Northern Railway Co. receives cash in settlement of its account for carriage, hence its personal account must be DEBITED, and Cash Account CREDITED in respect of the money paid.

(Note that this transaction, which is quite distinct from (3) above, does not require any entry in Carriage Account, as it affects only Cash and the Railway Company.)

(6) *Payment to the Colliery Company.*—This transaction is similar to (5) above, therefore the entries will be DEBIT the Seafield Colliery Co.'s account and CREDIT Cash Account.

Entries in the Journal.

The transactions enumerated on pages 9–10 will appear in the Journal as follows :—

JOURNAL OF THE RETAIL COAL STORE.

Folio 1.

			Dr.			*Cr.*		
19..			£	s.	d.	£	s.	d.
Jan. 1	Cash Account . . . . *Dr.*	1	100	0	0			
	To Capital Account of A. Brown .	2				100	0	0
	Being amount of cash introduced by A. Brown.							
„ 2	Coal Account . . . . *Dr.*	5	75	0	0			
	To Seafield Colliery Co. . .	7				75	0	0
	Being purchase of 50 tons of coal at 30s. per ton ex colliery.							
„ 10	Carriage Account . . . . *Dr.*	6	31	5	0			
	To Northern Railway Co. . .	3				31	5	0
	Being carriage on coal from Seafield Colliery Co.							
„ 20	Alfred Jones . . . . . *Dr.*	4	118	15	0			
	To Coal Account	5				118	15	0
	Being sale of 50 tons of coal at 47s. 6d. *per ton.*							
„ 30	Northern Railway Co. . . . *Dr.*	3	31	5	0			
	To Cash Account	1				31	5	0
	Being payment of their account for carriage on coal.							
„ 30	Seafield Colliery Co. . . . *Dr.*	7	40	0	0			
	To Cash Account	1				40	0	0
	Being part payment of their account for coal supplied.							
	Total .		£396	5	0	£396	5	0

THE LEDGER

As previously stated, the Ledger is a book which contains, in a summarised and classified form, a permanent record of all transactions. The book is divided into separate sections, called accounts, each of which usually occupies one page, although it may extend to two or more pages, while, on the other hand, several accounts may be included on a single page. The pages (known as " folios ") are numbered consecutively, and any account can be turned up quickly by reference to the alphabetical index provided.

The following is a specimen ruling of a ledger account :—

Dr. SPECIMEN LEDGER ACCOUNT. *Cr.*

Date.	Particulars.	Journal Folio.	Amount.	Date.	Particulars.	Journal Folio.	Amount.
19..			£ s. d.	19..			£ s. d.

It will be noticed that the form of a ledger account differs in several important respects from that of the journal. A ledger account is divided into two sections by a central vertical line, and on the left-hand side are placed the debit entries and on the other side the credits. The abbreviations " Dr." and " Cr." are placed at the top left- and right-hand corners respectively, whilst columns are provided on each side for the date, the nature of the transaction, the journal folio, and the amount respectively. The nature of the transaction specified in the second column is usually indicated by stating the name of the other account included in the journal entry. An account may therefore be defined as a statement in which are recorded all the transactions of one specific class, which have taken place during a given period.

The transactions entered in the Journal on page 11 will appear in the Ledger thus :—

Account No. 1.

Dr. CASH ACCOUNT. *Cr.*

19..			£	s.	d.	19..			£	s.	d.
Jan. 1	To Capital . .	J. 1	100	0	0	Jan 30	By Northern Railway Co. . .	J. 1	31	5	0
						„ 30	„ Seafield Colliery Co. . .	J. 1	40	0	0

Account No. 2.

Dr. CAPITAL ACCOUNT OF A. BROWN. *Cr.*

19..			£	s.	d.	19..			£	s.	d.
						Jan. 1	By Cash . . .	J. 1	100	0	0

Account No. 3.

Dr. NORTHERN RAILWAY CO. *Cr.*

19..			£	s.	d.	19..			£	s.	d.
Jan. 30	To Cash . . .	J. 1	31	5	0	Jan 10	By Carriage . .	J. 1	31	5	0

Account No. 4.

Dr. ALFRED JONES. **Cr.**

			£	s.	d.				£	s.	d.
19..						19..					
Jan. 20	To Coal . . .	J. 1	118	15	0						
	b/d										

Account No. 5.

Dr. COAL ACCOUNT. **Cr.**

			£	s.	d.				£	s.	d.
19..						19..					
Jan. 2	To Seafield Colliery Co. . . .	J. 1	75	0	0	Jan 20	By Alfred Jones .	J. 1	118	15	0

Account No 6.

Dr. CARRIAGE ACCOUNT. **Cr.**

			£	s.	d.				£	s.	d.
19..						19..					
Jan. 10	To Northern Railway Co. . . .	J. 1	31	5	0						

Account No. 7.

Dr. SEAFIELD COLLIERY CO. **Cr.**

			£	s.	d.				£	s.	d.
19..						19..					
Jan. 30	To Cash . . .	J. 1	40	0	0	Jan. 2	By Coal . . .	J. 1	75	0	0

The Prefixes "To" and "By."

The above accounts exemplify the method of entering transactions in the Ledger. It will be noted that the word "To" is prefixed to the debit entries, and that the word "By" is written before the credit entries.

The reason for the use of these particular words will not be clear unless they are read in conjunction with the abbreviations "Dr." and "Cr." at the head of each account; thus, considering the account of the Northern Railway Company, on the 10th January this company becomes a creditor *by* the value (£31 5s.) of the service rendered in carrying coal, and on the 30th January becomes a debtor *to* the firm in respect of cash £31 5s. sent to it. As the Railway Company is thus both a debtor and a creditor for the same amount, its account balances. The facts implied by the words "to" and "by" will now be apparent, and they must never be omitted, either in the examination room or in practice.

It should be noted that, at 31st January, the credit balance on the account of the Seafield Colliery Co. signifies this company to be a *creditor* of the Retail Coal Store, and that the debit balance on A. Jones' account shows that this customer is a *debtor*.

Literally, a debtor is a person who owes money to another, while a creditor is a person to whom money is owing.

The foregoing ledger accounts illustrate in the simplest form the three classes, viz., Personal, Real and Nominal Accounts. The accounts of the Seafield Colliery Co., of the Northern Railway Co., and of Alfred Jones are Personal Accounts; Cash Account and Coal Account are Real (or Property) Accounts; and Carriage Account is a Nominal Account. The proprietor's Capital Account is usually regarded as the personal account of the proprietor with the business. It can, however, be argued that, as the Capital Account records the difference between the total value of the property, etc., belonging to the business (assets), and the total amount owing by the business (liabilities), it should be classed as a nominal account.

The Trial Balance.

In the preceding pages we have traced the transactions of the Retail Coal Store through the Journal into the Ledger. A complete record of the transactions now appears in the seven ledger accounts, but it is not possible to see, at a glance, whether the dealings have resulted in a profit or a loss, nor is it possible to ascertain immediately the exact financial position of the business after its first month of trading. These two important items of information will be obtained by preparing a Profit and Loss Account and Balance Sheet, but before doing so, we may well pause to check the arithmetical accuracy of our records. That this can be done by the simple expedient of preparing a *Trial Balance* is one of the great advantages of double entry book-keeping.

We already know that as the dual aspect of every transaction must be recorded, both a debit and a credit entry are required for every transaction. This being so, it follows that if we prepare a statement, called a Trial Balance, showing in separate columns the *totals* of all the debit and credit entries in the ledger, then the totals of the two columns should agree. If they do not, it indicates that one or more errors have occurred either in posting to the ledger, or in the additions of the accounts, or in the extraction from the ledger of the figures for the Trial Balance.

A variation of the above procedure is to show in the Trial Balance, not the *totals* of the debit and credit postings, but only the debit and credit *balances* on the ledger accounts (as explained below, this method is nearly always used in practice). A little consideration will show that the same result is achieved in both cases: the entries in the ledger are proved to be correct in one case because the totals of the debit and credit postings balance each other, and in the other case because the total of the debit *balances* in the ledger is equal to the total of the credit *balances*. In this connection it should be noted that the *balance* of a ledger account is represented by the excess of the total of the entries on one side of the account over the total of the entries on the opposite side of the same account.

The following specimen shows the Trial Balance of the Retail Coal Store, prepared to show the totals of the debit and credit postings in addition to the balances of the accounts :—

THE RETAIL COAL STORE.

Trial Balance as at 31st January, 19..

Ledger Folio.	Name of Account.	Total Postings.		Balances.	
		Dr.	*Cr.*	*Dr.*	*Cr.*
		£ s. d.	£ s. d.	£ s. d.	£ s. d.
1	Cash . .	100 0 0	71 5 0	28 15 0	
2	Capital . .		100 0 0		100 0 0
3	Northern Railway Co. .	31 5 0	31 5 0		
4	Alfred Jones .	118 15 0		118 15 0	
5	Coal . .	75 0 0	118 15 0		43 15 0
6	Carriage . .	31 5 0		31 5 0	
7	Seafield Colliery Co. . .	40 0 0	75 0 0		35 0 0
		£396 5 0	£396 5 0	£178 15 0	£178 15 0

It will be found in practical book-keeping that the accounts in the ledger are too numerous to permit the compilation of a four-column Trial Balance without involving a considerable amount of unnecessary labour, and it is accordingly usual to prepare Trial Balances in two-column form, by extracting only the *balances* of the ledger accounts. When working out exercises for examination purposes this practical method of only showing the balances of the ledger accounts in the Trial Balance should always be adopted, unless the question specifically requires otherwise.

It is important to note that a Trial Balance is merely a statement prepared to check the arithmetical accuracy of the book-keeping entries up to a particular date, which should be stated at the head of the Trial Balance. No posting can ever be made to a Trial Balance, for it is *not* an account, neither is it a part of the ledger or of the journal.

THE PROFIT AND LOSS ACCOUNT

In ordinary circumstances a trader does not wish to ascertain his profit or loss *on each separate transaction*, and he is content if his system of account keeping enables him to determine whether the aggregate of his transactions during a given period—usually one year—has resulted in a profit or a loss.

In order that this information may be forthcoming, he opens in his ledger a Nominal Account called "Profit and Loss Account," to which, at the end of the period under review, he transfers through the journal: (*a*) the *gross profit* realised—that is, the excess of

the amount charged to customers in respect of goods sold over the amount paid for them by the seller (in the case of the Retail Coal Store, this is represented by the balance of the Coal Account); and (*b*) the balances of any other Nominal Accounts in the ledger which relate to items of income or expense. The transfers are effected through the journal, it being remembered that there must never be a debit entry in the ledger without a corresponding credit, and *vice versa.*

The amount of gross profit is placed to the *credit* of the Profit and Loss Account, for this account receives the benefit of the profits made by the business. Similarly, any other items of income or gain are placed to the credit of this account. On the other hand, losses and items of expense, such as carriage, are debited to the Profit and Loss Account, for these items must be *charged against* the gross profits of the business.

The journal entries necessary to effect the transfers of the balances on the nominal ledger accounts (shown on page 13) are as follows:—

JOURNAL.

Folio 2

			Dr.			*Cr.*		
19..			£	s.	d.	£	s.	d
Jan. 31	Coal Account . . . . *Dr.*	5	43	15	0			
	To Profit and Loss Account . .	8				43	15	0
	Being gross profit for month ending 31st January, 19..							
Jan. 31	Profit and Loss Account . . *Dr.*	8	31	5	0			
	To Carriage Account . . .	6				31	5	0
	Being transfer of expenses incurred during January, 19..							

When these transfers have been effected, the Profit and Loss Account will show on the credit side the gross profit on trading, together with any other income and gains, and on the debit side, the expenses and losses. The resulting balance of this account will represent the net profit or net loss for the period covered by the account, i.e., if the total of the credit side exceeds the total of the debit side the balance will be the net profit, whereas if the total of the debit side exceeds the total of the credit side the balance will be the net loss.

When the balance of the Profit and Loss Account is ascertained, the profit (if one has been made) will belong to the proprietor, and the amount must be transferred to the *credit* of his Capital Account. On the other hand, if the trading results in a loss, the proprietor's capital is diminished, and this loss must, therefore, be transferred to the *debit* of his Capital Account.

In the business under consideration a net profit of £12 10s. was made during the month of January, so the journal entry to transfer this profit to the Capital Account of A. Brown will be—

Folio 2.

			Dr.	Cr.
19..			£ s. d.	£ s. d.
Jan. 31	Profit and Loss Account . . *Dr.*	8	12 10 0	
	To Capital Account of A. Brown .	2		12 10 0
	Being transfer of net profit made during January, 19..			

The completed Profit and Loss Account will appear thus :—

Account No. 8.

PROFIT AND LOSS ACCOUNT

Dr. FOR MONTH ENDED 31ST JANUARY, 19.. *Cr.*

19..			£ s. d.	19..			£ s. d
Jan. 31	To Carriage . .	J. 2	31 5 0	Jan. 31	By Gross Profit on Coal Sold .	J. 2	43 15 0
	„ Balance, being Net Profit for month transferred to Capital Account	J. 2	12 10 0				
			£43 15 0				£43 15 0

Striking the Balance.

Balancing an account sometimes presents a little difficulty because the balance is first shown on the opposite side to that expected, i.e., a *debit* balance first appears on the *credit* side. A moment's thought, however, will show that if the total of the debit items exceeds the total of the credit items the difference between the two sides must be placed on the credit side in order to make the totals of the two sides agree. The balance is then brought down to the opposite side, i.e., the correct side, and will represent the commencing point of the account for the succeeding period.

A *debit* balance indicates that the total debits exceed the total credits, whilst a *credit* balance shows that the total credits are greater than the total debits.

In practice a trader would rarely draw up a formal profit and loss account at the end of only one month's trading, although he may possibly extract a trial balance from his books in order to ensure that they are arithmetically accurate, and he may also draft out a rough profit and loss account for his own information. Periodically, however, usually every six or twelve months, the trader would proceed systematically to balance his books and to draw up his Profit and Loss Account and Balance Sheet (as explained later in this Chapter).

In the present example we will assume that he has decided to draw up his Balance Sheet and to "close his books," as it is termed, at the end of his first month's trading. The entries shown in the Journal on page 16 will be made in the relative accounts, and every account in the Ledger will then be ruled off, and the balance, if any, brought down on the opposite side of the account as the opening balance for the ensuing period.

When the closing entries in the journal have been posted to the respective ledger accounts, the completed accounts will appear in the following form :—

Account No. 1.

Dr. CASH ACCOUNT. *Cr.*

19..			£ s. d.	19..			£ s. d.
Jan. 1	To Capital	J. 1	100 0 0	Jan. 30	By Northern Railway Co. . .	J. 1	31 5 0
				,, 30	,, Seafield Colliery Co. . . .	J. 1	40 0 0
				,, 31	,, Balance *carried down* . .		28 15 0
			£100 0 0				£100 0 0
Feb. 1	To Balance *brought down* . .		28 15 0				

Account No. 2.

Dr. CAPITAL ACCOUNT OF A. BROWN. *Cr.*

19..			£ s. d.	19..			£ s. d.
Jan. 31	To Balance *carried down* . .		112 10 0	Jan. 1	By Cash . . .	J. 1	100 0 0
				,, 31	,, Profit and Loss Account .	J. 2	12 10 0
			£112 10 0				£112 10 0
				Feb. 1	By Balance *brought down* . .		112 10 0

Account No. 3.

Dr. NORTHERN RAILWAY CO. *Cr.*

19..			£ s. d.	19..			£ s. d.
Jan. 30	To Cash . . .	J. 1	31 5 0	Jan. 10	By Carriage . .	J. 1	31 5 0

Account No. 4.

Dr. ALFRED JONES *Cr.*

19..			£ s. d.	19..			£ s. d.
Jan. 20	To Coal . . .	J. 1	118 15 0				

NOTE.—It is unnecessary to carry down the balance when only one entry appears in the account, since the balance is obviously the same amount.

Account No. 5.

Dr. COAL ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 2	To Seafield Colliery Co.	J. 1	75 0 0	Jan. 20	By Alfred Jones .	J. 1	118 15 0
„ 31	„ Profit and Loss Account . .	J. 2	43 15 0				
			£118 15 0				£118 15 0

Account No. 6.

Dr. CARRIAGE ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 10	To Northern Railway Co.	J. 1	31 5 0	Jan. 31	By Profit and Loss Account .	J. 2	31 5 0

Account No. 7.

Dr. SEAFIELD COLLIERY CO. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 30	To Cash . .	J. 1	40 0 0	Jan. 2	By Coal . . .	J. 1	75 0 0
„ 31	„ Balance *carried down* . .		35 0 0				
			£75 0 0				£75 0 0
				Feb. 1	By Balance *brought down* . .		35 0 0

THE BALANCE SHEET

The books of the Retail Coal Store have now been completely written up, and show that a profit has been made by the first month's trading. The next and final step is to draw up a simple statement which shows at a glance the financial position of the business. This statement, known as a Balance Sheet, consists of a classified summary of all the ledger balances remaining open on a given date, after the balances of the nominal accounts have been transferred to the Profit and Loss Account.

For convenience, a Balance Sheet is divided vertically into two parts, showing on the left-hand side the balances which represent *liabilities* of the business, including the balance of the capital account (this being the amount owing by the business, as such, to the proprietor as an individual), and on the right-hand side the balances representing the *assets*, or property, of the business. This form is invariably adopted in Great Britain, but there is no reason, apart from custom, why the sides should not be reversed or the assets shown above or below the liabilities; in fact, the practice in America is to show the liabilities (credit balances) on the right-hand side and the assets (debit balances) on the left.

It was stated, when dealing with the Trial Balance, that as every debit has a corresponding credit, the total of all the debits must equal the total of all the credits in the accounts as a whole, or, in other words, that the total of all the debit balances must exactly equal the total of all the credit balances. It follows, therefore, that, if the book-keeping has been carried out correctly, the two sides of the Balance Sheet must agree exactly, in just the same way as the two sides of the Trial Balance agree.

It must be particularly noted that while the Profit and Loss Account is a ledger account, to which items are posted through the journal, the Balance Sheet, like the Trial Balance, is only a *statement*. As its name implies, it is simply a classified summary of *balances* at a certain date and is *not* an account, so that there can be no question of transfers to the Balance Sheet.

THE RETAIL COAL STORE.

Balance Sheet as at 31st January, 19..

Liabilities		£ s. d.	*Assets*	£ s. d.
Creditor :—			Debtor :—	
Seafield Colliery Co. . .		35 0 0	A. Jones . .	118 15 0
A. Brown—Capital Account :—	£ s. d.			
Balance as at 1st January 19..	100 0 0			
Add Profit for month .	12 10 0		Cash	28 15 0
		112 10 0		
		£147 10 0		£147 10 0

NOTE.—In practice, the names of the debtors and creditors are *not* normally shown in the Balance Sheet, all debtors and creditors being included under the general headings "Sundry Debtors" and "Sundry Creditors" respectively.

From this Balance Sheet, which is prepared from the ledger accounts given on pages 18 and 19, it can be seen that on 31st January the business had £28 15s. in cash, and an amount of £118 15s. owing to it. On the other hand, the business owed £35 to a creditor, and £112 10s. to its proprietor.

The foregoing example is an illustration of a trader's transactions showing, in the simplest possible form, how double entry is effected, maintained and completed from the initial entry of the first transaction to the construction and compilation of the final accounts and Balance Sheet.

THE CASH BOOK

When double entry book-keeping was first introduced, trading was undertaken on a much smaller scale than at present, and no great amount of work was entailed in passing each separate transaction through the journal; but as business operations were conducted on an increasing scale it became necessary to devise means whereby short cuts could be introduced, and the detailed work of book-keeping distributed over a staff of perhaps dozens of clerks, instead of being performed by a single individual.

The first step in this direction was the separation of the Cash Account from the ledger, and the adoption of a separate Cash Book in which to record all cash transactions. It is obvious that in the majority of businesses the number of transactions involving the receipt or the payment of cash must easily outnumber those of any other type of transaction, and the convenience afforded by binding up the cash account as a separate book has only to be mentioned to be appreciated. It must, however, be distinctly understood that the Cash Book is a part of the ledger, and is bound up separately simply as a matter of expediency.

The journalising of cash items is now recognised as an unnecessary duplication of labour, and accordingly the present practice is to enter all cash receipts and payments directly into the Cash Book without first passing the entries through the journal. The Cash Book thus fulfils the functions of both a ledger account and a journal.

Cash receipts are value coming in; hence amounts of cash received are entered on the debit side of the Cash Book and posted to the credit of the appropriate ledger accounts. In other words, corresponding credit entries are made in the ledger accounts of the persons or things giving the value. Similarly, *cash payments* are value going out; such transactions must therefore be recorded on the credit side of the Cash Book, and posted to the debit of the ledger accounts of the persons or things receiving the value.

As the Cash Book is primarily a ledger account, it is in its simplest form ruled similarly to any other ledger account, thus:—

CASH BOOK.

Dr. *Cr.*

Date.	Accounts.	Ledger Folio.	Amount.	Date.	Accounts.	Ledger Folio.	Amount.
19..			£ s. d.	19..			£ s. d.

The Cash Book now in general use is of a somewhat more advanced type than that shown in the above illustration. Similarly, the journal has been largely superseded by other subsidiary books. Examples of these, with explanations, will be given in later chapters, but for the present, students will confine their attention to the simple Journal, Cash Book and Ledger.

The art of correct journalising is the foundation-stone of accuracy and efficiency in double entry book-keeping, and as it is imperative that students should be proficient in this essential

feature before proceeding to more advanced stages, a more comprehensive example of a trader's transactions will now be considered, illustrating the use of the Journal in conjunction with a *Cash Book and Ledger, and leading up to the compilation of the Trial Balance.*

EXAMPLE.

W. Speedy is in business as a Furniture Dealer, and on 1st January, 19.. his position is as follows :—

Assets.

Cash at Bank, £685 ; Debtors :—L. Pain, £260 ; C. Pirrie, £124 ; Goods in stock, £986 ; Motor Van, £180 ; Shop Fittings, £200.

Liabilities.

Creditors :—W. Smith, £320 ; D. Perkins, £490.

His transactions are as follows :—

19..

(1) Jan. 3. Purchased from C. Hall, 100 carpets at 22s. 6d. each.
(2) „ 4. Sold to C. Brown, 12 bedsteads at 85s. each.
(3) „ 5. Paid Wages, £24.
(4) „ 5. Paid Rent, £38.
(5) „ 6. Paid W. Smith on account. £220.
(6) „ 8. Sold to C. Pirrie—
50 mattresses at 60s. each.
50 mattress covers at 8s. 6d. each.
50 bolsters at 8s. each.
100 pillows at 4s. each.
(7) „ 8. Received £200 on account from L Pain.
(8) „ 10. Purchased from W. Smith—
3 mahogany tables at £5 10s. each.
1 settee for £10.
(9) „ 12. Purchased from D. Perkins, 10 bedsteads at 38s. 6d. each.
(10) „ 12. Paid Wages, £24.
(11) „ 12. C. Pirrie paid his account, £335 5s.
(12) „ 12. Paid Sundry Expenses, £4 10s.

Enter the above items in W. Speedy's Journal, Cash Book and Ledger Close the books on 12th January and prepare a Trial Balance as at that date.

The Opening Entries.

With regard to the opening entries, the assets are represented in the Ledger by debit balances and the liabilities by credit balances ; hence, in journalising these items the accounts recording assets are debited and the accounts recording liabilities are credited. W. Speedy's capital is the amount by which his assets exceed his liabilities ; this also is a credit balance. For the sake of convenience, the whole of the items are combined in one compound or "composite" journal entry, the debits being collected together and entered on successive lines, followed by the credit entries, which are treated in the same manner. Where entries are combined in this way, it is customary to open with "Sundries, *Dr.* To Sundries" as shown in the following example, although, in practice, these words are sometimes omitted.

Cash at Bank is included in this opening journal entry in order to show Speedy's complete position and to comply with the axiom "*the sum of the debits must equal the sum of the credits.*"

The opening journal entries are as follows :—

JOURNAL.

Folio 1.

			Dr.			*Cr.*		
19..			£	s.	d.	£	s.	d.
Jan. 1	Sundries *Dr.*							
	To Sundries							
	Cash at Bank	C.B. 1	685	0	0			
	Sundry Debtors :—	Led.						
	L. Pain	2	260	0	0			
	C. Pirrie	3	124	0	0			
	Goods Account (Stock) . .	10	986	0	0			
	Motor Van	8	180	0	0			
	Shop Fittings	9	200	0	0			
	To Sundry Creditors :—							
	W. Smith	4				320	0	0
	D. Perkins	5				490	0	0
	„ Capital Account . .	1				1,625	0	0
	Being assets, liabilities and capital at this date.							
			£2,435	0	0	£2,435	0	0

How the Transactions are Recorded.

The transactions are dealt with in the following manner :—

(1) The stock of goods is increased by this purchase, therefore Goods Account, which " receives " the articles, is debited, and C. Hall, who "gave" the articles, is credited.

(2) In this transaction, C. Brown "receives" the goods, while the stock is decreased by the sale, hence C. Brown is debited as the " receiver," and Goods Account is credited.

(3) This transaction is in respect of work performed by certain employees who "gave" their services. Strictly speaking, there should be four entries ; the first two debiting " Wages Account " as the receiver of the benefit of these services and crediting the employees. Upon payment, the remaining entries would be to debit the individual employees who received the cash and to credit the Cash Book as the "giver." In practice, this method is shortened, no personal accounts being opened for the employees, either individually or collectively, but on payment of the amount the item is entered on the credit side of the Cash Book and is posted direct to the debit of Wages Account.

(4) This item is treated similarly to (3), viz., by a credit entry in the Cash Book and a debit to Rent Account in the ledger.

(5) W. Smith "receives" £220, which is "given" by the Cash Book, hence the item is entered on the credit side of the Cash Book and is posted to the debit of W. Smith's personal account in the ledger.

(6) This transaction is similar to (2), hence C. Pirrie is debited, while Goods Account, which yields the benefit, is credited.

(7) This item, being a cash receipt, is entered on the debit side of the Cash Book and posted to the credit of L. Pain's personal account.

(8) and (9) These transactions are dealt with in a similar manner to (1); Goods Account being debited, whilst the accounts of W. Smith and D. Perkins are respectively credited.

(10) As in (3), this item is entered on the credit side of the Cash Book and debited to the Wages Account.

(11) This transaction is dealt with as indicated for (7).

(12) As with Wages and Rent, enter the payment on the credit side of the Cash Book, and post to the debit of Sundry Expenses Account.

The Journal, Cash Book and Ledger Accounts recording the above transactions appear as follows :—

JOURNAL.

Folio 1.

				Dr.	*Cr.*
19..				£ s. d.	£ s. d.
Jan. 3	Goods Account . . . . *Dr.*		10	112 10 0	
	To C. Hall		6		112 10 0
	Being purchase of 100 *carpets at* 22*s.* 6*d. each.*				
" 4	C. Brown . . . . . *Dr.*		7	51 0 0	
	To Goods Account		10		51 0 0
	Being sale of 12 *bedsteads at* 85*s. each.*				
" 8	C. Pirrie . . . . . *Dr.*		3	211 5 0	
	To Goods Account		10		211 5 0
	Being sale of 50	£ s. d.			
	mattresses at 60*s.* .	150 0 0			
	50 *mattress covers at* 8*s.* 6*d.* . .	21 5 0			
	50 *bolsters at* 8*s.* .	20 0 0			
	100 *pillows at* 4*s.* .	20 0 0			
		£211 5 0			
" 10	Goods Account . . . . *Dr.*		10	26 10 0	
	To W. Smith		4		26 10 0
	Being purchase of 3				
	mahogany tables	£ s. d.			
	at £5 10*s.* 0*d.* .	16 10 0			
	1 *settee* . . .	10 0 0			
		£26 10 0			
" 12	Goods Account . . . . *Dr.*		10	19 5 0	
	To D. Perkins		5		19 5 0
	Being purchase of 10 *bedsteads at* 38*s.* 6*d.*				
				£420 10 0	£420 10 0

CASH BOOK.

Folio 1.

Dr. Date.	*Receipts.* Accounts.	Fo.	Amount.	Date.	*Payments.* Accounts.	Fo.	*Cr.* Amount.
19..			£ s. d.	19..		Led.	£ s. d.
Jan. 1	To Balance .	J. 1	685 0 0	Jan. 5	By Wages . .	11	24 0 0
		Led.		„ 5	„ Rent . .	12	38 0 0
„ 8	„ L. Pain . .	2	200 0 0	„ 6	„ W. Smith .	4	220 0 0
„ 12	„ C. Pirrie .	3	335 5 0	„ 12	„ Wages . .	11	24 0 0
				„ 12	„ Sundry Expenses .	13	4 10 0
				„ 12	„ Balance *carried down*		909 15 0
			£1,220 5 0				£1,220 5 0
Jan. 13	To Balance *brought down*		909 15 0				

CAPITAL ACCOUNT.

Account No. 1.

Dr							*Cr.*
19..			£ s. d.	19..			£ s. d.
				Jan. 1	By Balance	J. 1	1,625 0 0

L. PAIN.

Account No. 2.

Dr.							*Cr.*
19..			£ s. d.	19..			£ s. d.
Jan. 1	To Balance	J. 1	260 0 0	Jan. 8	By Cash . .	C.B. 1	200 0 0
				„ 12	„ Balance *carried down*		60 0 0
			£260 0 0				£260 0 0
Jan. 13	To Balance *brought down*		60 0 0				

C. PIRRIE.

Account No. 3.

Dr.							*Cr.*
19..			£ s. d.	19..			£ s. d.
Jan. 1	To Balance .	J. 1	124 0 0	Jan. 12	By Cash	C.B. 1	335 5 0
„ 8	„ Goods . .	J. 1	211 5 0				
			£335 5 0				£335 5 0

Account No. 4.

Dr W. SMITH. *Cr.*

			£ s. d.				£ s. d.
19 .				13..			
Jan. 6	To Cash	C.B. 1	220 0 0	Jan. 1	By Balance	J. 1	320 0 0
„ 12	„ Balance *carried down*		126 10 0	„ 10	„ Goods	J. 1	26 10 0
			£346 10 0				£346 10 0
				Jan. 13	By Balance *brought down*		126 10 0

Account No. 5

Dr. D. PERKINS. *Cr.*

			£ s d.				£ s. d.
19..				19..			
Jan. 13	To Balance *carried down*		509 5 0	Jan. 1	By Balance	J. 1	490 0 0
				„ 13	„ Goods	J. 1	19 5 0
			£509 5 0				£509 5 0
				Jan. 13	By Balance *brought down*		509 5 0

Account No. 6.

Dr. C. HALL. *Cr.*

			£ s. d.				£ s. d
19..				19..			
				Jan. 3	By Goods	J. 1	112 10 0

Account No. 7.

Dr. C. BROWN. *Cr.*

			£ s. d.				£ s. d.
19..				19.			
Jan. 4	To Goods	J. 1	51 0 0				

Account No. 8.

Dr. MOTOR VAN. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 1	To Balance	J. 1	180 0 0				

Account No. 9.

Dr. SHOP FITTINGS. **Cr.**

19..			£ s. d.	19..			£ s. d.
Jan. 1	To Balance	J. 1	200 0 0				

Account No. 10.

Dr. GOODS ACCOUNT. **Cr.**

19..			£ s. d.	19..			£ s. d.
Jan. 1	To Balance .	J. 1	986 0 0	Jan. 4	By C. Brown .	J. 1	51 0 0
„ 3	„ C. Hall .	J. 1	112 10 0	„ 8	„ C. Pirrie .	J. 1	211 5 0
„ 10	„ W. Smith .	J. 1	26 10 0	„ 12	„ Balance *carried down*		882 0 0
„ 12	„ D. Perkins .	J. 1	19 5 0				
			£1,144 5 0				£1,144 5 0
Jan. 13	To Balance *brought down*		882 0 0				

Account No. 11.

Dr. WAGES **Cr.**

19..			£ s. d.	19..			£ s. d.
Jan. 5	To Cash .	C.B. 1	24 0 0	Jan. 12	By Balance *carried down*		48 0 0
„ 12	„ Cash .	C.B. 1	24 0 0				
			£48 0 0				£48 0 0
Jan. 13	To Balance *brought down*		48 0 0				

Account No. 12.

Dr. RENT **Cr.**

19..			£ s. d.	19..			£ s. d.
Jan. 5	To Cash .	C.B. 1	38 0 0				

Account No. 13.

Dr. SUNDRY EXPENSES. **Cr.**

19..			£ s. d.	19..			£ s. d.
Jan. 12	To Cash .	C.B. 1	4 10 0				

W. SPEEDY

Trial Balance as at 12th January, 19..

Folio.	*Name of Account.*	*Dr.* £ s. d.	*Cr.* £ s. d.
1	Capital Account		1,625 0 0
2	L. Pain	60 0 0	
4	W. Smith		126 10 0
5	D. Perkins		509 5 0
6	C. Hall		112 10 0
7	C. Brown	51 0 0	
8	Motor Van	180 0 0	
9	Shop Fittings	200 0 0	
10	Goods Account	882 0 0	
11	Wages	48 0 0	
12	Rent	38 0 0	
13	Sundry Expenses	4 10 0	
C.B.1	Cash at Bank	909 15 0	
		£2,373 5 0	£2,373 5 0

The foregoing example terminates at the Trial Balance, the information given in the particulars being insufficient for the compilation of the Profit and Loss Account and Balance Sheet. For instance, it is necessary to know the value of the goods remaining unsold on 12th January in order to ascertain the amount of gross profit resulting from the transactions during the period. If it is assumed that the value of the unsold stock on 12th January was £950, the Goods Account can be completed in the following manner :—

Dr. GOODS ACCOUNT. *Cr.*

19..		£ s. d.	19..		£ s. d.
Jan. 1	To Balance (value of Goods on hand) .	986 0 0	Jan. 4	By C. Brown . .	51 0 0
„ 3	„ C. Hall . .	112 10 0	„ 8	„ C. Pirrie . .	211 5 0
„ 10	„ W Smith . .	26 10 0	„ 12	„ *Balance (value of Goods on hand) c/d.* . . .	950 0 0
„ 12	„ D. Perkins . .	19 5 0			
„ 12	„ *Balance—Gross Profit transferred to Profit and Loss Account* . .	68 0 0			
		£1,212 5 0			£1,212 5 0
Jan. 13	To Balance *b/d.* .	950 0 0			

NOTE.—The abbreviations "c/d" and "b/d" can be used in place of "carried down" and "brought down" respectively.

The closing value of stock on 12th January forms the commencing value for the next period. This method of constructing the Goods Account is, however, now *obsolete* for practical purposes. Modern book-keeping methods provide for the subdivision of accounts so as to ensure that more classified information is

available. Hence, the Goods Account is divided into three separate accounts, viz. :—

(*a*) Stock Account ;
(*b*) Goods Sold (or Sales) Account ;
(*c*) Goods Bought (or Purchases) Account.

The purpose of the first of these accounts is to record the stock, or balance of goods on hand at the beginning and end of the trading period. The second account is credited with the proceeds of all outgoing goods, while the third account is debited with the cost of all incoming goods. At the end of the trading period, these accounts are closed by transferring the balances to a *Trading Account*, the balance of which represents the gross profit (or loss) for the period covered by the account.

Assuming that the foregoing exercise had been dealt with in this way, the accounts recording W. Speedy's transactions in "goods" will appear as shown on this and the next page, the closing journal entries being as follows :—

JOURNAL.

		Dr. £ s. d.	*Cr.* £ s. d.
19.. Jan. 12	Trading Account . . . . *Dr.*	986 0 0	
	To Stock Account		986 0 0
	Being value of stock on 1*st Jan.* 19..		
,, 12	Trading Account . . . . *Dr.*	158 5 0	
	To Purchases Account . . .		158 5 0
	Being total purchases for period.		
,, 12	Sales Account . . . . . *Dr.*	262 5 0	
	To Trading Account . . .		262 5 0
	Being total sales for period.		
,, 12	Stock Account . . . . . *Dr.*	950 0 0	
	To Trading Account . . .		950 0 0
	Being value of stock on hand at this date.		
		£2,356 10 0	£2,356 10 0

Dr. STOCK ACCOUNT. *Cr.*

		£ s. d.			£ s. d.
19.. Jan. 1	To Balance	986 0 0	19.. *Jan.* 12	*By Trading Account* .	*986 0 0*
Jan. 12	*To Trading Account* .	*950 0 0*			

Dr. PURCHASES ACCOUNT. *Cr.*

		£ s. d.			£ s. d.
19.. Jan. 3	To C. Hall .	112 10 0	19.. *Jan* 12	*By Trading Account* .	*158 5 0*
,, 10	,, W. Smith .	26 10 0			
,, 12	,, D. Perkins .	19 5 0			
		£158 5 0			£158 5 0

Dr. SALES ACCOUNT. **Cr.**

		£	s.	d.			£	s.	d.
19..					19..				
Jan. 12	*To Trading Account*	*262*	*5*	*0*	Jan. 4	By C. Brown	51	0	0
					„ 8	„ C. Pirrie	211	5	0
		£262	5	0			£262	5	0

TRADING ACCOUNT.

Dr. FOR PERIOD FROM 1ST JANUARY TO 12TH JANUARY, 19.. **Cr.**

		£	s.	d.			£	s.	d.
19..					19..				
Jan. 1	To Stock	986	0	0	Jan. 12	By Sales	262	5	0
„ 12	„ Purchases	158	5	0	„ 12	„ Stock	950	0	0
„ 12	„ Balance, being Gross Profit, carried to Profit and Loss Account	68	0	0					
		£1,212	5	0			£1,212	5	0

These accounts are more fully explained in a subsequent chapter. For the present, students are recommended to work their exercises as far as the Trial Balance only, journalising all transactions other than cash, which, as explained, will be fully recorded in the Cash Book. It is again emphasised that sound knowledge of the main principles of double entry, and facility in the art of making correct entries, is to be acquired only by a thorough study of the Journal, and constant practice in its use.

EXERCISE 1.

A. Define Double Entry Bookkeeping.

B. Explain the uses of the Journal, Cash Book and Ledger.

C. What are Real, Personal and Nominal Accounts? Give an example of each.

D. E. J. Turner started in business as a wholesale fruit dealer on 1st September. At that date his assets were as follows:—

Cash, £1,012; Stock of Fruit, etc., £175; Fittings, Baskets, etc., £21. He had no liabilities.

You are required to open his Ledger as on 1st September, with the above particulars and to post thereto, through the Journal and Cash Book, the understated transactions:—

19..

Sept. 1. Bought for cash 50 bushels of "Cox's Orange" apples, at 9s. per bushel.

„ 3. Sold, on credit, to B. Brown, 20 bushels "Worcester Pearmain" apples, at 8s. 6d. per bushel.

„ 4. Paid wages, in cash, £5 7s. 6d.

19..
Sept. 5. Bought, on credit, from R. Robinson & Co., 30 bushels "William" pears, at 10s. per bushel.
„ 6. Paid in cash, carriage £3 17s. 2d.
„ 8. Sold, on credit, to S. Smith, 10 bushels of "Cox's Orange" apples, at 10s. 9d. per bushel.
„ 9. Bought, on credit, from J. Jones & Son, 56 bushels of "James Grieve" apples, at 8s. 10d. per bushel.
„ 9. S. Smith returned half a bushel of apples sold him on the 8th inst., as "not up to sample." [*Debit Fruit (or Goods) Account and credit S. Smith.*]
„ 10. Paid R. Robinson & Co. the amount of their account.
„ 11. B. Brown & Co. paid their account.
„ 12. Purchased, for cash, new weighing machine, £9 10s.
„ 13. Paid, in cash, wages £6 10s.

Balance the Cash Book and Ledger as on 13th September, and extract a Trial Balance.

E. James Crowther started business on 1st January as a General Dealer. On that date the state of his affairs was as follows :—

Cash, £343 5s. 10d. Stock on Hand, £258 10s. 6d. Furniture and Fittings, £94. Sundry Debtors: H. Dickson, £18 10s.; M. Ravary, £39 17s. 6d.; H. V. Machin, £26 18s. 4d. Sundry Creditors: H. Hadley, £12 4s. 8d.; M. Melody, £21 4s. 6d.

Open the accounts necessary to record the above particulars in the Ledger, and post thereto, through the Journal and Cash Book, the following transactions :—

19..
Jan. 2. Sold to M. Ravary on credit, 4 rolls serge at £15 10s. 6d. per roll.
„ 3. Paid wages £6 7s. 6d.
Bought, on credit, from H. Hadley, 50 oilskin coats at £1 11s. 6d. each.
„ 5. H. Dickson paid his account.
„ 6. Paid the amount owing to M. Melody.
Cash sales for week, £32 8s. 6d.
„ 8. Bought for cash, 16 overcoats at £2 2s. each.
„ 9. Paid H. Hadley the amount of his account.
„ 10. Purchased, for cash, new office desk, £12 10s. [*Debit Office Furniture Account and credit Cash.*]
Paid wages £7 10s., and office expenses, £1 8s. 7d.
„ 12. M. Ravary paid £25 on account.
„ 14. Cash sales for week, £42 10s. 8d.

Balance the Cash Book and Ledger as on 14th January, and extract a Trial Balance.

F. A. Welwyn commenced business on 1st January as a cloth merchant with £1,000 cash. His stock in hand consisted of ten rolls of Tweed, which cost £28 per roll, purchased in December, on credit, from G. Serge & Sons, but not yet paid for. Welwyn's transactions for the month of January were as follows :—

19..
Jan. 1. Sundry Expenses, £2.
„ 3. Purchased, on credit, from Chatenay & Co., Velvet £92.
„ 4. Sold, on credit, to George Dickson, 3 rolls Tweed, at £34 per roll.
„ 5. Paid wages, £7 10s.
„ 6. Sold, for cash, 5 yards of Tweed, at 20s. per yard.
„ 7. Received cash from George Dickson, for the amount of his account.
„ 8. Paid G. Serge & Sons their account.
„ 10. Returned to Chatenay & Co. Velvet value £12, damaged. [*Debit Chatenay & Co., and credit Goods Account.*]
„ 12. Paid wages, £8 15s.
„ 13. Paid carriage, £1 2s. 6d.

19..
Jan. 14. Purchased, on credit, from D. Barton, Tweed, £64 8s. 6d.
„ 15. Sold, on credit, to R. Alexander & Co., Tweed, £28 9s.

Open the Ledger Accounts and post the above transactions thereto, through the Journal and Cash Book. Balance the Ledger, bring down the balances and extract a Trial Balance as on 15th January.

G. F. Heat started in business as a coal merchant on 1st October. At that date he possessed a horse and cart, valued at £120, and cash, £550. He owed £100 to his brother, H. Heat, for money lent.

Heat's transactions during October were as follows :—

19..
Oct. 2. Purchased, on credit, 50 tons of best household coal from Nuneaton Colliery Co., at 68s. per ton.
„ 4. Sundry Expenses, £5 15s. 2d.
„ 5. Sold, on credit, to George Norwood, 15 cwt. of coal, at 4s. 8d. per cwt.
„ 6. Sold, for cash, 5 cwt. of coal, at 4s. 6d. per cwt.
„ 8. Paid salaries and wages, £8 2s. 6d.
„ 11. Purchased, on credit, from B. Farmer, 1½ tons of hay, at £8 per ton.
„ 12. Paid Nuneaton Colliery Co. the amount of their account.
„ 16. George Norwood paid his account
„ 18. Paid salaries and wages, £9 18s. 7d.
„ 19. Purchased, on credit, from Cardiff Coal Co., 20 tons steam coal, at 62s. per ton.
„ 22. Sold, on credit, to Bracebridge Flour Mills, Ltd., 10 tons steam coal, at 68s. per ton.
„ 23. Returned to B. Farmer, ½ ton of hay, damaged.
„ 26. Cardiff Coal Co., allowed 15s. for short weight in coal purchased from them on the 19th instant.

Open the ledger accounts and post above transactions thereto, through the Journal and Cash Book. Balance the Ledger, bring down the balances and extract a Trial Balance as on 26th October.

H. A. Argent commenced business, as a wholesale draper, on 1st January. His financial position on that date was as follows :—

Cash, £594; Furniture and Fittings, £372; Stock on hand, £985; Debtor: D. Perkins, £78; Creditor: A. Barbier, £303.

Open the necessary accounts in the Ledger to record the above particulars, and post thereto, through the Journal and Cash Book, the following transactions :—

19..
Jan. 2. Purchased, on credit, from D. Dennison :—
3 dozen wool scarves at 5s. 11d. each.
1 gross beaded trimmings at 4s. 6d. per dozen
„ 4. Returned, to D. Dennison, 6 scarves as faded.
„ 6. Paid salaries and wages, £32.
„ 6. Paid £200, on account to A. Barbier.
„ 8. Purchased, for cash, job lot of 20 velour costumes at two guineas each.
„ 10. Sold, on credit, to D. Perkins, 50 costumes at £2 12s. 6d. each.
„ 13. Paid office salaries and wages. £34.
„ 14. Cash sales to date, £87.
„ 16. Paid for packing materials, £49; railway carriage, £12 4s. 6d.
„ 17. D. Perkins sent cash in settlement of his account.
„ 20. Purchased, for cash, new show case, £75.
„ 22. Paid D. Dennison the amount of his account

Balance the Ledger and Cash Book, as on 22nd January, and extract a Trial Balance.

CHAPTER II

SALES, PURCHASES AND OTHER JOURNALS

The Journal and its Sub-divisions.

The Journal is the original book of prime entry in which all transactions, other than the receipt and payment of cash, are entered before being posted to the Ledger. But in all except the smallest businesses it is physically impossible for a single clerk to journalise the whole of the transactions, and as it is equally impossible for numerous clerks to work simultaneously on the same book, it obviously becomes necessary, in such circumstances, for more than one journal to be provided, or for the journal to be split up into several separate sections.

In practice the latter alternative is adopted, and because the majority of journal entries can be divided into a few broad classes, the principal journal is divided into a number of subsidiary journals, each of which is reserved for the recording of one particular class of transaction, e.g., sales or purchases.

This method of dividing up the Journal has a dual advantage ; it enables the individual book-keeper to concentrate his attention upon one class of entry, so permitting him to achieve the maximum speed and accuracy ; and it reduces considerably the work of posting to the Ledger and tends to keep this book free from unnecessary detail.

For example, if six sales were made to A, B, C, D, E and F respectively, the ordinary journal entries would be :

		Dr. £ s. d.	*Cr.* £ s. d.
A's Account	*Dr.*	15 7 3	
To Sales Account . . .			15 7 3
B's Account	*Dr.*	4 2 4	
To Sales Account . . .			4 2 4
C's Account	*Dr.*	81 0 0	
To Sales Account . . .			81 0 0
D's Account	*Dr.*	17 1 11	
To Sales Account . . .			17 1 11
E's Account	*Dr.*	10 12 9	
To Sales Account . . .			10 12 9
F's Account	*Dr.*	5 19 1	
To Sales Account . . .			5 19 1
		£134 3 4	£134 3 4

By this method, twelve separate postings are involved, but if a journal is kept specially for sales transactions, practically half the clerical work can be eliminated by scheduling the various transactions in the *Sales Journal*, from which the *individual* debits are posted to the respective personal accounts, and the *total* of the credits to the Sales Account, thus:

SALES JOURNAL.

Date		Ledger Folio.	£ s. d.
	A's Account		15 7 3
	B's "		4 2 4
	C's "		81 0 0
	D's "		17 1 11
	E's "		10 12 9
	F's "		5 19 1
	Total credited to Sales Account .		£134 3 4

The subsidiary journal in which sales are recorded before posting to the ledger is variously known as the Sales Journal, the Sales Day Book, or the Sales Book.

Each of the items entered in this book is posted individually to the debit of the personal account affected, while the equivalent credit entry is made periodically (usually every week or month) to the Sales Account for the total sales of that period.

Thus, although there may be thousands of debit entries to various personal accounts, they are equalised *in total*, and the basic principle of double entry is fully maintained by the balancing credit entry in the Sales Account.

In a similar manner, separate books are used for—

(*a*) Purchases, which are recorded in the Purchase Journal; or, as it is alternatively called, the Bought Day Book, Bought Invoice Book, Purchases Day Book or Purchases Book.

(*b*) Returns inwards, i.e., goods previously sold which are returned by customers. These are recorded in the Sales Returns Book, sometimes termed the Returns Inwards Book.

(*c*) Returns outwards, i.e., goods purchased which are returned to the supplier. These are recorded in the Bought Returns Book, otherwise known as the Returns Outwards Book or Purchases Returns Book.

(*d*) Bill of Exchange transactions, which are recorded in the Bills Receivable Book or the Bills Payable Book as the case may be.

Credit Sales.

In cases where goods are sold upon credit terms, it is necessary that a full record of each transaction be made and kept available for future reference. This record will appear in the Sales Day Book and the Ledger, and an *Invoice* giving full particulars of the transaction will be sent to the customer. An Invoice may be defined as a statement containing a description of the goods sold, their quantity and prices, with a note of the terms arranged. The Invoice also serves as an advice that the goods have been dispatched.

The following is a specimen form of commercial invoice in general use :—

INVOICE.

12, ALDERSGATE STREET,
LONDON, E.C.1,
31st January, 19...

MESSRS. BROWN, LTD.,
5, HIGH STREET,
BEDFORD.

Bought of J. & A. MARSHALL.

Terms : 2½% Discount, Monthly Account.

			£	s.	d.	£	s.	d.
12	Oak Tables . . .	@ 85/-	51	0	0			
20	Oak Bedsteads . . .	@ 100/-	100	0	0			
			151	0	0			
	Less Trade Discount, 33⅓ %		50	6	8			
						£100	13	4
	Carr. Pd.							
	Per L.M. & S. Rly.							

Cash Sales.

When goods sold are paid for at the time of sale, there is no necessity to raise personal ledger accounts for each transaction, as, the sale being concluded, the identity of the customer is immaterial. More usually, a memorandum Cash Sales Book is kept to record particulars of such transactions, the total of each week's (or, preferably, each day's) takings in respect of cash sales being paid into the bank and entered on the debit side of the Cash Book, whence it is posted to the credit of Sales Account (or a special *Cash Sales* Account) in the Ledger.

Trade Discount.

This is a form of allowance which is made by manufacturers and wholesale dealers to agents or retail shopkeepers, and is a proportion allowed off the list or catalogue prices of goods supplied.

In many classes of business, particularly in the Furniture and Ironmongery trades, price lists and catalogues are issued giving standard (or retail) prices for the articles listed and described therein. As these price lists are often shown by retailers to prospective customers, the trade discount, which forms part of the agent's or the retailer's profit, is not disclosed in the price list, but is intimated to the dealer by means of a separate memorandum.

Again, in some trades, prices are subject to constant fluctuations. In such cases it is obviously advantageous for the manufacturer to be able to adjust his prices by simply advising his customers of an alteration in the rate of trade discount, instead of being compelled to incur the expense of revising and re-issuing his price lists and catalogues at frequent intervals.

The alteration of the rate of trade discount has the effect of adjusting quotations in the catalogue to the prevailing market conditions.

The effect of the trade discount—as between the manufacturer and the trader—is to reduce the price of the article to its true wholesale price. In modern practice, the trade discount is deducted from the gross selling price on the invoice, and only the net selling or purchase price appears in the respective Day Books. The net amount thus shown is entered by the seller in the total column of his Sales Day Book, and it is this net amount which is debited to the customer's personal account in the Sales Ledger. On his part the buyer enters the net amount only in his Purchases Book, crediting the same amount to the seller's account in the Bought Ledger. Specimen entries are shown on pages 40 and 47.

Cash Discount.

In order to induce customers to pay their accounts promptly, it is a common practice for the creditor to make a percentage allowance—termed "Cash Discount"—if the account is paid within a specified time. Thus, an account may be subject to a cash discount of 5 per cent. if paid within seven days from date of invoice, or "$2\frac{1}{2}$ per cent., monthly account."

The term "monthly account" is variously interpreted in different trades and even by different firms in the same trade. For example, it may mean "one month from date of invoice," but an equally common interpretation is that all goods invoiced during any given month must be paid for not later than the 15th day of the following month in order to secure the usual cash discount. Accounts not paid within the agreed period or by the fixed date are "net," i.e., must be paid in full without deduction of the discount.

Cash Discount is *not* deducted from the invoice nor from the entry in the Journal; the allowance is contingent upon payment

within the prescribed period, and it is recorded in the creditor's books only when the allowance is made, i.e., upon receipt of cash in settlement before the expiration of the period of credit given.

It is important to distinguish carefully between trade discount and cash discount; the two terms are not synonymous and, as has been explained above, they are differently treated in the books of account. It may happen that *both* classes of discount are allowable to the purchaser in respect of a particular transaction; but while trade discount is a definite allowance made unconditionally and irrespective of the date of payment, cash discount is allowable only if the stipulated conditions as to time of payment are fulfilled.

Goods Outwards Book.

It is a usual practice for all goods dispatched to customers to be recorded by the warehouseman, packer or other person responsible for their issue, in a Goods Outwards Book. This book does not form part of the double entry system, being purely a memorandum book or diary, suitably ruled to enable the quantity, quality and other particulars of outgoing goods to be conveniently recorded.

The main purposes of the book are to furnish information from which invoices can be subsequently prepared, and to provide evidence of dispatch in the event of disputes concerning delivery.

Goods Inwards Book.

When goods are received by a trader from suppliers, particulars are entered by the yard foreman or storekeeper in a Goods Inwards Book. The required particulars are usually obtained from the suppliers' delivery notes, which specify the quantity and description of each consignment, and which should be checked with the goods actually received. The book is similar in form to the Goods Outwards Book described above; it is merely a memorandum book and should not be regarded as a book of account. Its purpose is to provide, in case of dispute, a detailed record of the particular goods received and of the actual date of delivery.

SALES DAY BOOK

The sales effected by a trader ordinarily constitute the major part of his everyday transactions, hence in large businesses it is frequently found that two sales day books are in constant use for each sales ledger; one day book being used by the invoice clerk or clerks on Mondays, Wednesdays and Fridays, and the second book on Tuesdays, Thursdays and Saturdays. This method enables the ledger-keepers to post the sales of the previous

day to the ledger accounts without impeding the daily duties of the invoice clerks.

The following is a specimen of the Sales Day Book in its simplest form :—

SALES DAY BOOK.

Date.	Particulars.	Ledger Folio.	Details.	Invoice Total.
19..		*Posted to debit of the Personal Accounts.*	£ s. d.	£ s. d.
	Brought forward			1,078 1 2
Jan. 31	Brown, Ltd., 5 High Street, Bedford.			
	12 Oak Tables @ 85/- each		51 0 0	
	20 Oak Bedsteads @ 100/- ,,		100 0 0	
			151 0 0	
	Less 33⅓ % trade discount		50 6 8	100 13 4
Jan. 31	C. Pirrie, 10 Broadway, Croydon.			
	50 Mattresses, @ 60/- each net		150 0 0	
	50 Mattress Covers, @ 8/6 each net		21 5 0	
	50 Bolsters, @ 8/- each net .		20 0 0	
	100 Pillows, @ 4/- each net .		20 0 0	
				211 5 0
	Total (*posted to the credit of Sales Account*)			£1,389 19 6

In practice, the total of the Day Book is carried forward from page to page until the end of the month (or other period adopted), when the total for the period is credited to the Sales Account.

Where a trader's business consists of more than one department, each of which sells different articles or commodities, it is often desired to ascertain the results of the trading of each department separately. This may be achieved by using separate books for each department, but a more convenient method is to use a columnar form of Day Book with such additional analysis columns as may be required. An example is given on page 39. The combined totals of the analysis columns will, of course, equal the final total of the sales for the period as shown by the "Total of Invoice" column in the Columnar Day Book.

If it is desired to ascertain the actual profits made by each department of the business, other analysed records will be required in respect of the various departments. The Purchases Book must be ruled in a similar analytical form to the Sales Book, and separate records must be kept of the expenses of each department. In this way the trader is enabled to ascertain the profit earned—or loss sustained—by each section of his business.

COLUMNAR SALES DAY BOOK.

Date.	Particulars.	Sales Ledger Folio.	Details.	Total of Invoice.	Furniture.	China	Drapery.
			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
19.. Jan. 2	W. Cox & Company, Birmingham.	*Post each item to the debit of the Personal Account.*					
	1 Mahogany sideboard		25 0 0				
	less 10% trade discount		2 10 0				
				22 10 0	22 10 0		
„ 6	J. Edwards & Company, Croydon.						
	1 Drawing-room suite		22 0 0				
	less 5% trade discount		1 2 0				
				20 18 0	20 18 0		
„ 6	M. Davies & Company, Reading.						
	2 China tea services @ 21/6		2 3 0				
	1 „ dinner service		1 15 0				
				3 18 0		3 18 0	
„ 8	M. Baker & Company, Acton.						
	2 pieces Sheeting—144 yds. @ 1/2 . . .		8 8 0				
	1 piece Calico—60 yds. @ 9d. . . .		2 5 0				
				10 13 0			10 13 0
„ 8	W. Phillips & Company, Hammersmith.						
	6 pairs Curtains @ 7/6		2 5 0				
	6 „ Curtains @ 4/6		1 7 0				
				3 12 0			3 12 0
				£61 11 0	£43 8 0	£3 18 0	£14 5 0
				This amount to be agreed with the totals of the analysis columns.	*Post total to the credit of Furniture Sales Account.*	*Post total to the credit of China Sales Account.*	*Post total to the credit of Drapery Sales Account.*

COLUMNAR SALES DAY BOOK.

(SUMMARISED FORM.)

Date.	Invoice No.	Particulars.	Ledger Folio.	Total of Invoice.	Furniture.	China.	Drapery.
19..				£ s. d.	£ s. d.	£ s. d.	£ s. d.
Jan. 2	1	W. Cox. & Co.	*Post each item to debit of the Personal Account.*	22 10 0	22 10 0		
„ 6	2	J. Edwards & Co.		20 18 0	20 18 0		
„ 6	3	M. Davies & Co.		3 18 0		3 18 0	
„ 8	4	M. Baker & Co.		10 13 0			10 13 0
„ 8	5	W. Phillips & Co.		3 12 0			3 12 0
				£61 11 0	£43 8 0	£3 18 0	£14 5 0
				This amount to be agreed with the totals of the analysis columns.	*Post total to credit of Furniture Sales Account.*	*Post total to credit of China Sales Account.*	*Post total to credit of Drapery Sales Account.*

Carbon Duplicate Invoices.

In the example of a Columnar Sales Day Book given on page 39, it will be noted that the particulars in the first four columns practically amount to a copy of the relative invoices.

In practice it is more convenient to type and file a carbon copy of each invoice, numbered consecutively, and to enter up the Sales Day Book in the form given on page 40. Each entry is thus simplified by the omission of details, which can, however, easily be looked up by reference to the carbon copy invoice indicated by the number in the second column of the Day Book.

Each copy-invoice should be marked to show the folio upon which the sale appears in the Day Book, and, to facilitate the completion of the day book analysis columns, a summary showing the amounts applicable to each department should appear at the foot of the copy-invoice. All such copies should, of course, be filed in consecutive order to enable instant reference to be made to any particular invoice which may be required.

An alternative method of producing copy-invoices is to use manifold day books. In this case, the invoice forms are interleaved with blank sheets and bound in book form, each invoice being perforated to enable it to be detached. When an invoice is written out, a sheet of carbon paper is inserted immediately beneath it, and so a duplicate copy is obtained. The invoice is torn out and sent to the customer, the carbon copy being retained in the book as a permanent record from which the Sales Day Book is written up as described above. Again, the manifold book itself may be used as a Day Book, the postings to the ledger being made direct from the copy-invoices, each page being totalled and carried forward to the end of the month, when the final total is posted to the credit of Sales Account.

In some forms of this columnar day book the departmental analysis columns are given immediately after the customer's name, the ledger folio and invoice total columns being shown last. This variation in method does not affect the principle of the book, but, in practice, it is usually found more convenient to have the name, ledger folio column and amount as close together as possible in order to facilitate the posting of the Sales Ledger.

Goods on Approval or on Sale or Return.

Goods are frequently sent to customers "on approval," but as such transactions are not sales, and as the trader remains the owner of the goods until the prospective buyer has signified his acceptance of them, such goods should not be treated in the books as ordinary sales. They must not be entered in the Sales Day Book, but it is necessary for the particulars to be entered in a

special book, which may be ruled in a style similar to that shown below :—

GOODS ON SALE OR RETURN BOOK.

Date.	Particulars.	Cash Details.	Total of Pro Forma Invoice.	Date sold or returned	Sales Ledger Folio.	Goods sold.	Goods re-turned.
19..		£ s. d. *	£ s. d.	19..		£ s. d.	£ s. d.

* This column is unnecessary if duplicate invoices are filed.

This book is both a memorandum book and a special sales day book. When goods are despatched, the selling price is entered in the "Cash Details" and "Total of Invoice" memorandum columns, and no further entry is made until it is known that the goods have been accepted or returned. In the latter case they are entered in the "Goods returned" memorandum column, and neither the entries made when the goods were despatched nor upon their return affects the double entry. If the goods are sold they are extended to the "Goods sold" column and posted to the debit of the customer's account in the Sales Ledger. The total of this column is subsequently posted to the credit of Sales Account.

The difference between the total of the "Pro Forma Invoice" column and the combined totals of the "Goods sold" and "Goods returned" columns represents the goods out on approval at any given date. For stocktaking purposes these goods outstanding must be reduced from selling price to cost price, and treated as ordinary stock for Balance Sheet valuation purposes.

The advantages of a special Sale or Return Day Book are :—

(1) At stocktaking goods out "on approval" cannot be treated as ordinary sales, and thus cause the gross profit shown to be fictitious.

(2) A duplication of the work of invoicing and passing through the books, and of crediting and passing through the books is avoided.

Where the number of sale or return transactions is considerable it may be necessary to extend the above ruling, in order to avoid unnecessary labour in bringing forward the details of outstanding goods; this can be achieved by increasing the size of the book and arranging sections which will enable the balance to be carried forward to a succeeding period on the same page as the original entries. An example appears on page 44. All goods sent out during a period are entered in the left-hand section of the Day Book and those which have not been sold or returned

at the end of the period are entered in the balance column. This enables the left-hand section to be finally totalled and ruled off, the subsequent sale or return of the goods being entered in the right-hand portion.

In order that a proper check may be kept upon the amount of goods outstanding it is necessary to keep the sale or return book up to date. Further reference to this matter is made in Chapter VII, when the question of stocktaking is considered.

Cash Purchases.

These transactions are comparatively rare, but when they occur, they are usually treated in a similar manner to Cash Sales. Upon payment of an amount in respect of such purchases an entry thereof is made on the credit side of the Cash Book and the item is subsequently posted to the debit of Purchases Account. Care must be observed to see that these items are correctly treated because occasionally such articles as new desks, office stools, loose plant or tools may be purchased for cash, in which cases the amounts must be debited to Office Furniture, Loose Tools, or other asset account as the case may be, and not to Purchases Account. In such instances, the entries in the Cash Book must show clearly the nature of the transactions, so that the correct postings may be made to the ledger.

PURCHASES BOOK OR PURCHASES JOURNAL

This book, which is sometimes styled the Bought Day Book or Bought Invoice Book or Purchases Day Book is, in form, similar to the Sales Day Book.

The following specimen illustrates a form in common use in small businesses :—

PURCHASES BOOK.

Date.	Particulars.	Ledger Folio.	Details.	Total of Invoice.
19..			£ s. d.	£ s. d.
Jan. 3	C. Hall, Kidderminster.	*Posted to credit of Personal Accounts*		
	100 Carpets @ 22s. 6d. each		112 10 0	
	Less 20% trade discount .		22 10 0	
				90 0 0
„ 10	W. Smith, 12 Curtain Road, Shoreditch.			
	3 Mahogany tables @ £5 10s. each		16 10 0	
	1 Settee		10 0 0	
			26 10 0	
	Less 10% trade discount .		2 13 0	
				23 17 0
„ 12	D. Perkins, Birmingham.			
	10 Bedsteads @ 38s. 6d. each			19 5 0
	Total (*posted to the debit of Purchases Account*)			£133 2 0

SALE OR RETURN DAY BOOK.

				"Period" Ended............					"Period" Ended............				
Date.	Particulars.	Total of Pro Forma Invoice.	Date Sold or Returned	Goods Returned.	Goods Sold.	Sales Ledger Folio.	Balance at end of "Period."	Date Sold or Returned.	Goods Returned.	Goods Sold.	Sales Ledger Folio.	Remarks.
19..		£ s. d.	19..	£ s. d.	£ s. d.		£ s. d.	19..	£ s. d.	£ s. d.		

In practice, the totals are carried forward until the end of the month (or other period adopted), so that the periodical total is debited in one amount to the Purchases Account.

It is usual to find that invoices for purchases are numbered consecutively, as received, so that they can be filed in numerical order; and in these cases detailed particulars of the purchases are not given in the Purchases Book. The entries made are then confined to—

Date.	Name.	Invoice No.	Led. Fol.	Total of Invoice.

For convenience, the Invoice number is sometimes entered in the ledger in addition to the folio of the Purchases Book, so that if, at any time, it is desired to refer to an invoice, the Bought Ledger will immediately give the number to which reference should be made.

The Purchases Book is normally used solely for the purpose of recording goods purchased on credit *for resale*. If any other expenses (e.g., stationery, carriage, repairs, etc.) are incurred, or if any assets are purchased on credit, they require, in theory, to be passed through the Principal Journal (see later in this Chapter). In practice, however, this difficulty can be overcome by the use of a Columnar Purchases Book, which will now be described.

Columnar Purchases Book.

Where there are several departments in a business, an analytical Purchases Book is used similar in form to the Sales Day Book illustrated on page 40, except that additional columns are provided for expenses and for purchases of goods which are not solely applicable to any one department, e.g., Carriage, Packing Materials, Stationery, etc. The use of these columns minimises the postings to the real and nominal accounts affected. Even where a business consists of one department only, an analytical Purchases Book is frequently used to classify the expenditure on various other items in addition to purchases of goods for re-sale.

The example given on page 47 is a simple form of Purchases Book. The number of columns may be increased indefinitely according to the number of departments and other requirements of the business. For example, if the business buys furniture, china and drapery for re-sale in separate departments, the "Materials" column would be replaced by three columns for furniture, china and drapery respectively. Again, if the business is one which makes numerous purchases of a commodity such as coal in connection with its manufactures, a separate column headed "fuel" would be provided for this class of expense.

Individually, the items are posted to the credit of the accounts of the respective suppliers in the Bought Ledger, while the totals are posted to the debit of the appropriate real or nominal accounts.

Where there is no specific analysis column for the particular

purchase or expense in respect of which an invoice or statement is received, the amount is extended into the "ledger" column provided, whence it will be posted to the debit of the account concerned.

It frequently happens that several classes of goods are obtained from the same supplier and charged on one invoice. It is then necessary to analyse the invoice before entering it in the Columnar Purchases Book. To facilitate the latter operation, it is usual to mark each invoice, as received, with a rubber stamp, and to indicate in the spaces provided the appropriate analysis column or columns affected and other particulars, thus :—

INVOICE.

LONDON, 17*th January*, 19...

THE A. B. TRADING COMPANY, LTD.

Dr. to J. & A. MARSHALL.

Terms : net.

	£	s.	d.
To 9 Cross Cartons @ 1d. each	5	8	0
„ 5,000 11″×8″ Summit Manilla Envelopes @ £2	10	0	0
	£15	8	0

Goods Inwards Book folio . .			*102*
Purchase authorised by . . .			*R.J.*
Prices checked by . . .			*P.S.*
Extensions checked by . . .			*P.S.*
Purchase Day Book folio . .			*74*
	£	s.	d.
Analysis :—			
Packing . . .	5	8	0
Stationery . .	10	0	0
	£15	8	0

RETURNS BOOKS

These books are ruled to correspond with the Sales Day Book and Purchases Day Book, and where the columnar method is employed for sales and purchases, the same columns must also be given in the returns books.

The Sales Returns Book (or Returns Inwards Book) is ordinarily used for goods returned to the trader, because they are not in accordance with order, or because they are unsuitable, defective, or otherwise unacceptable ; allowances and rebates also may be entered in this book. The individual items are posted

COLUMNAR PURCHASES BOOK.

Date.	Name.	Invoice No.	Bought Ledger Folio.	Total of Invoice.	Materials.	Packing.	Carriage and Cartage.	Stationery.	Ledger Folio.	Ledger Accounts.
19..				£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.		£ s. d.
Jan. 1	J. Cox & Co.	1	*Posted to credit of Personal Accounts.*	36 12 6	36 12 6					
,, 3	W. Jones & Co.	2		25 15 0	25 15 0					
,, 5	Office Supplies Co.	3		5 12 6				5 12 6		
,, 8	S. Lieber, Ltd.	4		6 15 0					71	Fittings and Fixtures. 6 15 0
,, 12	M. Baker & Co.	5		112 18 0	112 18 0					
,, 15	The Parcels Delivery Co.	6		6 15 0			6 15 0			
,, 17	J. Cox & Co.	7		12 10 0	12 10 0					
,, 17	J. & A. Marshall	8		15 8 0		5 8 0		10 0 0		
,, 20	The Excelsior Trading Co., Ltd.	9		11 15 0	11 15 0					
,, 26	Cartage Contractors, Ltd.	10		12 15 6			12 15 6			
				£246 16 6	£199 10 6	£5 8 0	£19 10 6	£15 12 6		£6 15 0
				This amount to be agreed with the totals of the analysis columns.	*Posted to debit of Materials Account.*	*Posted to debit of Packing Account.*	*Posted to debit of Carriage and Cartage Account.*	*Posted to debit of Stationery Account.*		*Each item posted to debit of the Account indicated.*

to the credit of the personal accounts affected, while the periodical totals of the analysis columns are posted to the debit of the respective Sales Account or to special Returns Inwards Accounts.

The Purchases Returns Book (sometimes termed the Bought Returns Book or Returns Outwards Book) records particulars of goods returned by, or allowances and rebates made to, the trader. The individual items are debited to the personal accounts concerned, while the periodical (e.g., monthly) totals of the analysis columns are credited to the Purchases Accounts affected or to special Returns Outwards Accounts.

Credit Notes.

It is customary for credit notes to be issued for goods returned or in respect of allowances made. A credit note has the reverse effect to an invoice, for it is a statement that the purchaser is credited with a specified amount, whereas an invoice is a statement that the purchaser is debited with a sum representing the value of the specified goods supplied. Usually, the body of the credit note is printed in red and the particulars also are detailed in red, so that these documents may be easily distinguished from invoices which are generally printed and written in black.

BILLS PAYABLE AND RECEIVABLE BOOKS

Where payment for a transaction is deferred for a few months, it is a common practice for a bill of exchange payable some time ahead to be drawn by the creditor on his debtor, by whom it is in due course "accepted" to signify that he undertakes to pay it on the expiration of the specified period. To the creditor who draws the bill upon his customer, the document is termed a *Bill Receivable,* inasmuch as it represents money to be *received* at some future time; to the debtor the document upon acceptance becomes a *Bill Payable,* representing money which he has to *pay* at some future date.

Transactions involving the drawing, accepting and negotiation of bills are recorded in Bills Receivable and Bills Payable Books. In the Bills Receivable Book are entered particulars of bills representing amounts to be received from other parties.

The entries in the Bills Receivable Book are made by the creditor when the bills are received from debtors, the amounts being posted from this book to the credit of the debtors' accounts, while the periodical totals are posted to the debit of the Bills Receivable Account in the Ledger. The Bills Receivable Book is thus a specialised form of journal.

In the Bills Payable Book are entered particulars of all bills acc[illegible] der for the purpose of paying at a future date [illegible] n to his creditors. The individual items are [illegible] ective creditors' accounts, and the periodical [illegible] the credit of Bills Payable Account in the [illegible] ansactions, with specimen forms and rulings

of the relative books and accounts, are more fully treated in Chapter V.

THE "PRINCIPAL" JOURNAL

It now remains to consider what entries are passed through the "principal" journal, or, as it is sometimes called, "the journal proper." As will be realised from the foregoing explanations of the functions of the Cash Book, Bills Receivable and Bills Payable Books, Purchases and Sales Journals, etc., the adoption of such subsidiary books for the majority of the transactions which occur, limits the use of the principal journal, both as to the nature and the number of the entries.

To ensure uniformity and effective supervision over the entries in the ledger, it is a generally accepted rule, in modern practice, that particulars of every transaction must be recorded in the principal journal, in one of the subsidiary journals, or in the cash book, before it is posted to the ledger. In other words, no entry should be made in a ledger account except as a posting from some book of "original entry."

Any transaction which cannot conveniently be entered in the cash book or in one of the subsidiary journals previously described, must be set out in the principal journal in a form which will facilitate the posting of the item to the ledger, and which will also give adequate particulars of the transaction for purposes of reference in the future.

The principal journal is particularly useful for recording opening, closing and adjusting entries, and it will be found later that these are nowadays practically its sole functions.

In some firms it is the practice to make direct transfers from one ledger account to another, but this procedure cannot be too strongly deprecated. It is quite true that the ledger is the ultimate destination of all entries, and that a saving of time and energy is effected by making direct transfers from one ledger account to another, but nevertheless it is distinctly advantageous to have the details of, and the reason for, every entry set out in the principal journal or in one of the other books of prime entry. The necessity for the detailing of correct and adequate particulars is of special importance in the following cases, for all of which the principal journal is generally used :—

(1) Opening a trader's books when he first commences business.
(2) Making adjustments in respect of errors.
(3) Making transfers and adjustments on the compilation of the periodical Trading and Profit and Loss Accounts.
(4) Special items which cannot be recorded in any other subsidiary book, e.g., entries on the purchase of the assets, etc., of another business.

By utilising the principal journal for these entries, it is possible to marshal and arrange the entries concisely in chronological order, with a short explanatory narration showing the reasons for the entries. Moreover, when the journal is used in this way, there is far less risk of errors being made in connection with the accounts, and of transfers being entered in one ledger account and omitted from another.

Classes of Entries.

Entries in the Journal may be divided into two classes, *simple* and *compound* (or *composite*). A simple entry is one in which only two accounts are affected, viz., one account to be debited and another to be credited with an equal amount.

In a compound entry there may be :—

(*a*) Several accounts to be debited and only one to be credited ; *or*

(*b*) One account to be debited and several to be credited ; *or*

(*c*) Several accounts to be debited and several others to be credited.

Journal entries falling within classes (*a*) and (*b*) are generally termed "single compound entries," and those in class (*c*) are generally termed "double compound entries." Usually, the individual items are of varying amounts, but the main principle of double entry applies throughout, and in all cases "the sum of the debits must equal the sum of the credits."

Compound entries principally occur in connection with opening and closing entries, examples of which are given on pages 23 and 121. A compound journal entry should not be made in order to combine two entries which are not related or which do not occur on the same date, or where there is no common account to be debited (or credited) in more than one instance.

The following illustration shows the use of the Journal in connection with the adjustment and correction of errors, and indicates the necessity for, and obvious use of, the narration :—

EXAMPLE.

Messrs Brown & Lord, Electrical Engineers, London, engaged Mr Hurst as their North of England representative. Under the terms of the agreement Mr Hurst is to receive one-tenth share of the net profits of the business, and in addition, $2\frac{1}{2}$ per cent. commission on all sales effected by him. The net profits for the year ended 31st December, 19. . amounted to £1,500, and Mr Hurst was duly paid £450, representing his share of profits and commission, as per agreement. Upon the accounts being audited, however, it was ascertained that Mr Hurst's commission had been under-estimated, the correct amount of sales effected by him being £14,117 13s.

You are required to give the journal entry necessary to rectify the above error.

JOURNAL.

			Fo.	Dr.	Cr.
19..				£ s. d.	£ s. d.
Dec. 31	Profit and Loss Account . . . *Dr.*			47 13 0	
	To Mr Hurst's Account . . .				47 13 0
	Being Commission of 2½% *on Sales amounting to* £14,117 13*s.*, *and* . .	£ s. d. 352 18 10			
	10% *Commission on Net Profits* * [£1,500—(£352 18*s.* 10*d.*, - £300)=£1,447 1*s.* 2*d.*] .	144 14 2			
		£497 13 0			
	Less Amount previously credited:				
	2½% *Commission on Sales amounting to* £12,000 . £300				
*	10% *Commission on Net Profits,* £1,500 . . 150	450 0 0			
	Extra Commission now credited	£47 13 0			

* Commission on sales must be charged before arriving at the net profits.

Special Journals.

In addition to the subsidiary books or journals already mentioned, special types of journals are used in some businesses or undertakings, e.g., auctioneers, estate agents, stockbrokers, insurance companies, shipping companies, etc. These special books necessarily vary according to the requirements of the business or undertaking, and according to the nature of the transactions which occur. Detailed consideration of the nature and purpose of such special journals is beyond the scope of this book, but it may be stated that the principle of subdivision and classification of the transactions to be recorded is their dominating feature. Hence, it will invariably be found that the individual detailed items are posted to the debit (or credit) of the various personal accounts, while the equalising credit (or debit) entries are made periodically *en bloc* to the appropriate nominal or real accounts.

The main purpose of the Journal—whether it is the principal journal or a subsidiary one—is to classify transactions into convenient groups so that time and labour may be saved in making postings to the Ledger.

EXERCISE 2.

A. James Tree, who was in business as a boot factor, had on 31st December, 19.., the following Assets and Liabilities :—

	£	s.	d.
Assets :			
Furniture and Fittings	148	10	0
Stock	649	12	6
Bill Receivable	50	0	0
Sundry Debtors :			
The Grosvenor Shoe Company	29	3	4
A. Foot & Son	19	0	0
J. Richardson	20	7	8
Cash	198	9	7
Liabilities :			
Loan	200	0	0
Sundry Creditors :			
A. Hall & Company	49	10	0
B. Bamforth	27	3	4
Paris Footwear, Ltd.	96	15	0

Ascertain James Tree's capital, and show the opening journal entry recording the above particulars.

B. On 1st January, 19.., the position of G. Chain was as follows :—Stock on hand, £1,468 4s. 6d. ; loan from G. Smith, £500 ; cash, £444 14s. 9d. ; bill payable, £100 ; furniture and fittings, £484 18s. 6d. ; owing by debtors, £1,142 4s. 9d. ; owing to creditors, £964 10s. 4d. ; investment in War Loan, £300.

What was the amount of Chain's capital on this date ? Construct the journal entry required to open his books.

C. S. Harlow is in business as a Wholesale Draper. On 1st January, 19.., his position was as follows :—

	£	s.	d.
Trade Debtors—H. Croft	782	10	0
E. Hurst	232	8	0
Trade Creditors—B. Williams	684	3	0
T. Small	984	8	0
Bill Receivable—J. Titmus	160	0	0
Cash	993	15	0
Stock on hand	1,064	18	0
Fixtures and Fittings	200	0	0
Motor Vans	1,200	0	0

Ascertain S. Harlow's capital, and show the opening journal entry recording the above particulars.

D. G. Maltby purchased £10,000 worth of goods from J. B. Clark in July, 19.. Maltby paid for these goods in the following month (August), but during the latter part of the same year he lost several contracts and, in December, asked Clark to re-purchase half the above goods for £5,000. This Clark agreed to do.

Show by means of journal entries and ledger accounts how these transactions should appear in Clark's books.

E. Write up the Sales Day Book and Purchases Book of George Pentiman for the following transactions :—

19..
Jan. 1. Sold, on credit, to G. Elgar, 100 pairs of blankets, @ 62s. per pair, subject to 10% trade discount.
„ 4. Purchased, on credit, from L. Pirrie, 200 pairs Witney blankets @ 43s. 6d. per pair, and 6 pieces (510 yards per piece) suede velveteen @ 3s. 9d. per yard.
„ 6. Sold, on credit, to G. Browning—
2 pieces (36 yards per piece) nainsook @ 9½d. per yard.
61 yards chiffon velvet @ 9s. 11d. per yard.
„ 7. Sold, on credit, to A. Chatenay, 1,000 yards corded velveteen @ 5s. 3d. per yard.
„ 14. Sold, on credit, to L. Moore, 50 lengths (15 yards per length) of Egyptian nainsook @ 8½d. per yard.
„ 16. Sold, on credit, to L. Whiteway, 58 towels, @ 1s. 0½d. each.

F. Enter the following transactions in Arthur May's Sales Day Book, Purchases Book, and Returns Books :—

19..
Jan. 2. Sold, on credit, to R. Pink, three doz. ladies' umbrellas, at 9s. 9d. each, less 10% trade discount.
„ 5. Purchased, on credit, from W. White, 2 doz. costumes, at 49s. 7d. each.
„ 7. Sold, on credit, to H. Black—
122 yards Jap silk, at 3s. 1d. per yard.
16 handbags, at 7s. 6d. each.
„ 18. Purchased, on credit, from W. Brown—
300 yards coating serge, at 2s. 5d. per yard.
76 pairs silk stockings, at 4s. 8d. per pair.
„ 24. Sold, on credit, to R. Green, six sets of furs, at 10 guineas per set.
„ 28. R. Green returned one set of furs, invoiced on the 24th instant, as damaged.

G. From the following particulars write up the Purchases Book of Arthur Bennett :—

19..
Jan. 1. Purchased from H. Walpole—
12 cwt. of refined sugar, at 30s. per cwt.
„ 2. Purchased from K. Murray—
56 lbs. of coffee, at 1s. 4d. per lb.
„ 3. Purchased from H. Moss—
15 cwt. of Indian rice, at 10s. 2d. per cwt.
„ 4. Purchased from H. Sells—
3 cwt. of refined sugar, at 36s. per cwt.
„ 5. Purchased from M. Christie—
1 cwt. of cocoa, at 1s. 10d. per lb.

H. Write up the Sales Day Book of the Bright Coal Co., Ltd., from the following particulars :—

19..
Jan. 1. Sold to Dumbleton Trading Co., 100 tons of Steam Coal at 19s. 6d. per ton.
„ 1. Sold to H. Carver, 6 tons of House Coal at 21s. 6d. per ton.
„ 2. Sold to Rowton Corporation, 80 tons of Steam Coal at 20s. per ton.
„ 3. Sold to the Blank Trading Co., 200 tons of Coal at 18s. 9d. per ton.
„ 5. Sold to S. Brown, 2 tons of Coal at 25s. per ton.
„ 7. Sold to Rowton Corporation, 120 tons of Steam Coal at 20s. per ton.

I. Compile the Sales and Purchases Day Books of W. Brown from the following particulars :—

19..
Jan. 2. Sold to H. Johnson 10 doz. of Sherry at 25s. a doz. and 1 pipe of Port at £70.
„ 2. Bought of W. Glass 30 doz. quart bottles at 2s. a doz. and 15 doz. pints at 1s. 6d. a doz.
„ 3. Bought from J. Lewis 10 hogsheads of Brandy at £40.
„ 6. Bought of A. Robinson 2 pipes of Port at £55 and 6 10-gallon casks of Whisky at £8 a cask.
„ 14. Sold to T. Kino 3 doz. Whisky at 39s., 2 doz. Port at 44s., 5 doz. Sherry at 25s., and 3 doz. Brandy at 60s.

J. Write up the Sales Day Book, Purchases Book and Returns Book of Alexander & Co., Furniture Manufacturers, from the following particulars :—

19..
Feb. 1. Purchased, on credit, from Paul Lester, Timber, value £13 3s. 3d.
„ 1. Sold, on credit, to Thomas Tree—
6 Dining-room Chairs at £1 13s. each.
6 Bedroom Chairs at £1 7s. 6d. each.
1 Chest of Drawers, £9 9s.
„ 1. Purchased on credit, from Frederick Smith, Timber, value £9 18s. 9d.
„ 2. Purchased, on credit, from George Tate—
Tapestry, £17 10s.
Trimmings, £3 16s. 6d.
Horsehair, £1 4s. 5d.
„ 2. Sold, on credit, to Robert Keys—
1 Dining-room Sideboard, £9.
1 Dinner Wagon, £2 10s.
2 Overmantels at £2 15s. each.
„ 3. Sent Credit note to Thomas Tree for overcharge of £1 1s. on Chest of Drawers sold to him on the 1st inst.
„ 4. Sold, on credit, to Philip Nares—
2 Library Chairs at £8 each.
1 Hall Stand, £7 10s.
1 Chesterfield, £15.

K. From the following particulars compile the Sales Day Book (with analysis columns) of James Owtram & Co., Engineers and Metal Merchants :—

19..
Jan. 3. Sold to Robinson & Co., 6 tons of pig-iron at 51s. 2d. per ton.
„ 5. Sold to J. Green & Son—
5 tons of sheet copper at £78 per ton.
„ 6. Sold to R. Black—
1 ton of pig-iron at 56s. per ton.
„ 9. Sold to J. Jones & Sons—
3 cutting machines at £24 each.
„ 9. Sold to J. Smith & Co.—
2 cwt. of sheet copper at £83 per ton.
„ 12. Sold to Robinson & Co.—
12 tons of pig-iron at 56s. 6d. per ton.
„ 15. Sold to J. Green & Son—
6 tons of pig-iron at 55s. per ton.

CHAPTER III

THE CASH BOOK

It has already been explained that the Cash Book is, in reality, a ledger account, which, for convenience and also because of the multiplicity of the entries passing through it, is not included in the general ledger but is bound as a separate volume. It will also be remembered that cash transactions are not journalised, and that the Cash Book therefore fulfils the functions both of a ledger account and book of "original entry" in which all cash transactions are entered as they occur.

A Cash Book may be defined as the book in which are recorded detailed particulars of all moneys received and paid. Receipts are entered on the debit side of the Cash Book and are subsequently posted to the credit side of the appropriate accounts in the ledger, while payments are entered on the credit side of the Cash Book and are posted to the debit side of the appropriate ledger accounts.

In its simplest form, the ruling adopted for a Cash Book is as shown in the specimen on page 56. The left-hand and right-hand sides of the cash book were formerly headed "Cash" and "Contra" respectively, but later these titles were superseded by the abbreviations "Dr." and "Cr." Although the present-day practice tends to the omission of both headings, students should always insert the abbreviations "Dr." and "Cr." at the head of the Cash Book in working examples.

The Treatment of Cash Discount.

Another example of the grouping together of items of a similar nature is that adopted for recording allowances of cash discount. In order to record such discounts a column is usually provided on each side of the Cash Book (as shown in the following example) to record particulars of cash discounts *allowed* upon amounts received from debtors and cash discounts *received* upon payments made to creditors.

The individual items of cash and discount on the debit side of the Cash Book are posted to the CREDIT side of the personal accounts, while the total of the discount column on the debit side of the Cash Book is posted periodically to the DEBIT of the Discounts Allowed Account in the Ledger. Similarly with the credit entries in the Cash Book; the individual items are posted

Dr. CASH BOOK *Cr.*

Date.	Particulars.	Led. Fo.	Discount Allowed.	Amount Received.	Date.	Particulars.	Led. Fo.	Discount Received.	Amount Paid.
19..			£ s. d.	£ s. d.	19..			£ s. d.	£ s. d.
Jan 1	To Balance *brought forward*			100 0 0	Jan. 2	By B. White		1 10 0	28 10 0
,, 2	,, A. Smith		1 5 0	23 15 0	,, 4	,, F. Robins		18 0	35 2 0
,, 4	,, J. Brown		10 0	9 10 0	,, 6	,, R. Wilson		5 0	9 15 0
,, 5	,, R. Jones		2 10 0	47 10 0	,, 6	,, Balance *carried down*			107 8 0
			£4 5 0	£180 15 0				£2 13 0	£180 15 0
			Total posted to Dr. of Discounts Allowed Account.					*Total posted to Cr. of Discounts Received Account.*	
19.. Jan. 7	To Balance *brought down*			107 8 0					

N.B.—In practice, the Cash Book is balanced periodically and the totals of each page are carried forward until the end of the period. The discount column totals are similarly carried forward, but are not balanced off at the end of the period, the columnar totals being posted to Discounts Allowed Account and Discounts Received Account as explained on page 57.

to the DEBIT of the personal accounts affected, while the total of the discount column is posted to the CREDIT of the Discounts Received Account. Separate entries may be made in the personal accounts for cash and discount, thus :—

Dr. A. SMITH. *Cr.*

				19..		C.B.	£. s. d.
				Jan. 2	By Cash .	Fo...	23 15 0
				„ 2	„ Discount Allowed .	„	1 5 0

The more practical method, however, is to make a composite entry, as shown in the following example :—

Dr. A. SMITH. *Cr.*

				19..			£ s. d.
				Jan. 2	By Cash and Discount .	C.B. Fo...	25 0 0

In respect of the items in the Cash Book shown on page 56, the Discounts Allowed Account and Discounts Received Account in the General Ledger will appear thus :—

Dr. DISCOUNTS ALLOWED ACCOUNT. *Cr.*

19..		C.B.	£ s. d.	19..			£ s. d.
Jan. 6	To Sundries .	Fo...	4 5 0				

Dr. DISCOUNTS RECEIVED ACCOUNT *Cr.*

19..			£ s. d.	19..		C.B.	£ s. d.
				Jan 6	By Sundries .	Fo...	2 13 0

It will be noticed that, as previously explained, the total of the discount column on the *debit* side of the Cash Book is posted to the *debit* side of Discounts Allowed Account.

This fact sometimes causes difficulty to students, as the general rule is "post from debit to credit," and vice versa, in order to complete the double entry. At first sight it appears that the posting of the periodical discount total is an exception to the rule. The difficulty will be overcome, however, if the student will regard the discount columns in the Cash Book as special Discount Journals, which are located in the Cash Book in order to permit of the simultaneous posting of cash and discount to the individual personal accounts. The principle of double entry is strictly adhered to; thus, the items contained in the "Discounts Allowed" column on the debit side of the Cash Book have been posted, in detail, to the *credit* side of the various personal accounts in the Sales Ledger at the same time as the cash items to which they

refer, and to complete the double entry the total of these items is posted to the *debit* side of Discounts Allowed Account.

It must be borne in mind also that the Discount Accounts are nominal accounts and that the entries are made therein in accordance with the rule "Debit Losses and Expenses; Credit Income and Gains." Discounts allowed to debtors are a "loss" to the trader, as the price of the goods sold by him is reduced by the amount of the discount; hence Discounts Allowed Account is debited while the accounts of the persons who "gain" the benefit of the allowance are credited. The discounts received are dealt with in a similar manner. The monthly total of the discount column on the *credit* side of the Cash Book is *credited* to the Discounts Received Account as it is a "gain" to the trader, while the accounts of the persons who allow the individual amounts (and to whom the allowances are losses) are *debited* with an equivalent amount.

Some traders post both discounts allowed and discounts received to the same Discounts Account, but in order to classify a trader's transactions as thoroughly as possible it is considered that it is preferable to open separate accounts for the two classes of discount, as explained above.

Banking Transactions.

As originally designed, the Cash Book recorded transactions in actual money only, but the development of banking and the extension of the use of cheques made unnecessary the use of cash for the settlement of all accounts.

Before describing the use of the Cash Book in connection with banking transactions, it will be convenient to consider the general relationship of a trader with his banker and the nature and effect of the transfer of money by means of cheques.

BANKER AND CUSTOMER

Primarily, the function of a banker is the acceptance of deposits of money from other people on the understanding that he will repay such money, or any portion of it, as and when required, to the depositors or to any person or persons nominated by them. Actually, a banker performs many other functions, and has other duties and responsibilities, but in ordinary circumstances the true relationship between a banker and his customer is that of debtor and creditor, the banker being usually the debtor.

It follows, therefore, that a trader's transactions with his banker are recorded in a similar manner to his transactions with any other person. Money received by a trader from his customers and handed to the banker is debited to the Bank Account and is credited to the customers' personal accounts, while money drawn from the bank and paid to another person is credited to the Bank Account and is debited to the account of the person who receives it, thus exemplifying the rule "Debit the receiver; credit the giver."

The practice of bankers is to receive money from their customers in two different ways, viz. :—

(*a*) *On Current Account*, withdrawable by cheque on demand. On this interest is not generally paid.

(*b*) *On Deposit Account*, which bears interest, varying with the notice required for withdrawals.

For ordinary business purposes, traders maintain current accounts with their bankers, to which they pay in their receipts and on which they draw cheques in favour of their creditors. The banker pays his customers' cheques up to the limit of the amount standing to their credit in his books without any intimation other than his customers' signatures on the cheques. By special arrangement, however, a banker will pay cheques in excess of this amount and allow his customer an " overdraft," but this usually necessitates the deposit of approved securities, or guarantees by third parties for the repayment of the amount advanced. When such a loan is granted the trader becomes the banker's debtor, and the normal relationship is reversed.

Deposit accounts are opened by persons who have more cash at the bank than they are likely to need in the immediate future. Cash on deposit can be withdrawn only on giving the bank an agreed period of notice, and earns interest according to the current rates in force. Cheques cannot usually be drawn against money on deposit account.

CHEQUES

Definition.

A cheque is defined by the Bills of Exchange Act, 1882, as a " bill of exchange drawn on a banker payable on demand." If the definition of a bill of exchange (see page 131) is incorporated in this definition, a cheque may be more fully described as " an unconditional order in writing, addressed by a customer to his banker, instructing the banker to pay on demand a stated sum of money to (1) a specified person, or (2) to the order of a specified person, or (3) to bearer."

A cheque requires a twopenny stamp, which is usually impressed, but may be adhesive. The person who signs the " order to pay " is termed the " drawer " ; the banker is the " drawee," and the person entitled to receive the money is termed the " payee."

A cheque is, therefore, a document which confers " a right to receive money," and in modern commercial practice, the greater part of a trader's transactions, both as regards receipts and payments, are settled by means of cheques.

Cheques may be drawn in two ways : (1) payable to the person named " or bearer," and (2) " to order," as shown in the example given on page 60. " Order " cheques require *indorsement*, that is, the payee must sign his name on the back before he can receive payment or transfer the cheque to someone else. " Bearer "

cheques are, however, payable or transferable without indorsement. The form of cheque in common use is sufficiently indicated by the following illustration :—

COUNTERFOIL.	CHEQUE.
No. Z40875	No. Z40875 ST ALBANS, *31st December*, 19..
31st Decr. 19..	**WESTMINSTER BANK, LIMITED.** ST ALBANS BRANCH. 2d. STAMP.
A. Jones & Co.	
(*Account No. 607.*)	PAY *A. Jones & Co.* OR ORDER
	Seventeen pounds four shillings & sixpence.
£17 : 4 : 6	*£17 : 4 : 6* *J. Brown.*

To prevent forgery and so as to preserve uniformity, bankers nowadays supply their customers with cheque forms (each bearing a 2d. impressed stamp), bound in book form, perforated, and with counterfoils as shown in the illustration. The particulars on the counterfoil give the information required when the credit side of the Cash Book is written up.

"Open" and "Crossed" Cheques.

Cheques may be either "open" or "crossed," the crossing taking the form of (*a*) two parallel lines written across the face of the cheque, with or without the words "& Co.," "Not Negotiable," etc., or (*b*) the name of a banker, with or without the parallel lines or the words "Not Negotiable," etc.

Open cheques may be cashed across the counter of the branch of the bank upon which they are drawn, but crossed cheques must be handed to a banker for collection, as the crossing is an indication that the cheque is to be payable only through a banker, or through the banker named, if the crossing is a special one. Thus, when a crossed cheque is received by a person who has no banking account, he must either exchange it for cash with some one who has a banking account, or arrange with a banker to collect payment from the drawee bank; for this service the collecting banker may charge the payee a small commission.

The chief characteristic of a cheque is that it is normally a fully *negotiable* instrument, i.e., a transferee for value who takes the instrument (cheque) in good faith, before it is overdue, and without notice of any defect in the title of the person from whom he gets it, acquires an *absolute* right to the instrument against all the world. This characteristic of negotiability is of great value

as it facilitates the transference by the payee of the full rights in the cheque, and the person to whom it is transferred obtains a good title undiminished by any claim or right of set off of other parties, provided he acts in good faith and without notice of defects of title. Further, if the cheque is stolen from the true owner (provided no forgery is involved), an innocent holder for value who has taken the cheque from the thief without notice of any defect in his title acquires a good title to it, and the loser of the cheque has no remedy against the drawer or other parties.

In order to protect the true owner against this risk of loss, the practice has arisen of writing the words " Not Negotiable " as part of the crossing on a cheque. These two words do not prevent negotiation in the commercial sense of the word (that is, the cheque may still be transferred from one person to another), but an innocent transferee who, in good faith and for value, takes a " not negotiable " cheque from a thief, does not possess a good title and is unable to enforce payment against the drawer.

Additional safeguards which may be adopted are :—

(1) Crossing the cheque specially to a banker ; *or*

(2) Adding to the crossing the words " Account payee only " or other words to that effect ; *or*

(3) Writing on the face of the cheque words indicating that its amount does not exceed a stated sum, e.g., " Under Ten Pounds."

The first method constitutes an instruction to the paying banker that the proceeds of the cheque are to be paid only to the banker named in the crossing, and a paying banker who disobeys this crossing by payment of the cheque to anyone other than the banker named is liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.

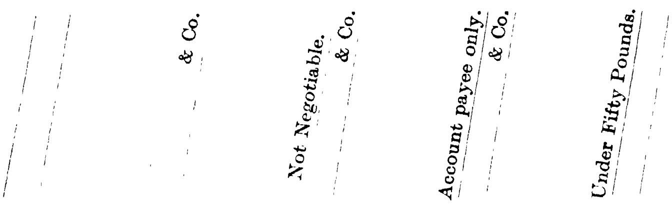
The second method is a direction to the collecting banker that the proceeds of the cheque are to be paid only to the credit of the payee named thereon. This method does not possess any statutory authority, but it is probable, however, that a collecting banker who disobeyed this crossing, without making adequate enquiries, would be held responsible for any loss sustained by reason of his negligence in not observing the instructions contained in the crossing.

The object of the third method is the prevention of fraud, as it renders it more difficult for a dishonest person to increase the amount of the cheque by any large sum.

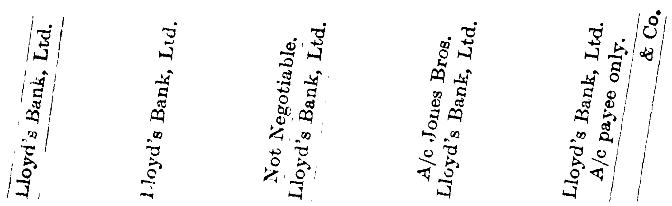
Forms of Crossing.

The principal forms of crossing in use are :—

General Crossings.



Special Crossings.



Conditional Cheques.

Some few years ago there was initiated a practice of issuing conditional cheques, i.e., printing upon cheques a notice that they are payable "subject to the form of receipt at foot hereof being duly stamped, dated and signed." The Bills of Exchange Act, 1882, however, provides that a bill of exchange (which includes a cheque) must be an *unconditional* order and, therefore, the statutory privileges and protection afforded by that Act in respect of cheques do not apply to instruments payment of which is made subject to a condition or conditions. For this reason, such instructions are usually couched in less imperative terms, but it is doubtful whether even these instruments are unconditional. Nevertheless, the practice of attaching a form of receipt, either at the foot, or on the back, of the cheque is frequently adopted by those who make a large number of payments by cheque. The advantage of this method is that the cheque acts as a receipt as well as an instrument of payment, and is thus an economical and labour-saving device ; the time ordinarily required for sorting, arranging and filing receipts being available for other work, whilst the trouble of writing to dilatory payees for receipts is avoided.

Unpaid Cheques.

Where a trader draws cheques in excess of the amount standing to his credit in the banker's books, without having previously arranged for an overdraft, the banker will ordinarily refuse payment and return the cheque to the payee, marked with a brief note as to the reason for non-payment, such as R/D (Refer to drawer).

Other markings on unpaid cheques include the following :—

(1) Account closed.
(2) Effects not cleared (i.e., the proceeds of cheques, bills, etc., paid in by the drawer have not been collected).
(3) No effects.
(4) E/I or I/E (Endorsement irregular).
(5) Words and figures differ.
(6) Payment stopped.
(7) Drawer deceased.

I/F (Insufficient funds) or N/S (Not sufficient funds) were previously used as alternatives to R/D, but in view of the fact that these answers involve a needless disclosure of the state of the customer's account, their use is now discontinued.

The Banker's Duties and Responsibilities.

A banker is bound to pay a customer's cheques to the extent of the balance standing to his credit or within the limits of any agreed overdraft, and any refusal to pay will make the banker liable in damages for any injury caused thereby to his customer's good name and credit.

The drawer is the only person who is entitled to stop payment of a cheque, but there are certain circumstances, e.g., death, bankruptcy, or the service of a garnishee order (i.e., an order of the Court in favour of a creditor, attaching funds of the debtor which are in the hands of a third party), in which the banker's authority to pay is automatically countermanded.

A banker must know his customer's signature, and if he pays away his customer's money against a signature which proves to be a forgery, he cannot debit the customer's account and must stand the loss himself. On the other hand, a banker who acts in good faith and without negligence in paying a cheque on which an endorsement is forged is not liable to his customer, for a banker cannot be expected to know the signatures of all the endorsers of cheques which pass through his hands for payment.

It may be added that the customer must not draw cheques in a negligent manner so that fraudulent alterations are facilitated. This, however, is a legal question which must be decided on legal principles, and the student desiring further information on the rights and liabilities of bankers is advised to consult a text book on Banking or Mercantile Law.

The Record of Bank Transactions.

When the system of payment by cheque first became general it was the custom of traders to keep separate accounts and separate books for transactions in actual money, and for transfers effected by means of cheques, through the bank, the former being known

as the Cash Account and the latter as the Bank Account. It is found, however, that transfers from one of these accounts to the other constantly take place, and it is therefore convenient to adopt a combined cash book to record both office cash and bank transactions.

In this form of cash book all moneys received (including cheques) are entered in the office cash column on the debit side. When any amount is paid into the bank, an entry is made on the credit side of the cash book in the cash column, and a corresponding entry is made on the debit side of the cash book in the bank column. The following example will clearly illustrate the use of this form of cash book :—

EXAMPLE

On 1st January, A. had a balance at his bank of £50, and his office cash in hand amounted to £4 17s. 9d.

On 2nd January he received from B. a cheque for £70 18s. 4d., and C paid him £7 3s. 2d., in cash.

On 3rd January he paid the cheque into the bank, together with £5 of the cash on hand in the office.

Write up these transactions in A.'s Cash Book. (*See page* 65.)

Three-Column Cash Books.

Where a trader frequently allows or receives cash discount, it is convenient for him to use a three-column cash book so as to include all the information relating to cash transactions in a single book. A fully worked example is shown on page 67, from which it will be seen that on the 3rd and 4th January the trader received cash amounting to £76 10s., which was therefore debited to office cash. This amount being more than was required for office purposes, £50 was withdrawn from office cash and paid into the bank. Accordingly, £50 was credited to office cash and debited to bank in the respective columns.

On 13th January, £30 was withdrawn from the bank to replenish the office cash balance, and this is shown on the credit side in the bank column ; the contra entry on the debit side appears in the cash column. A similar transaction takes place on 27th January, and this is dealt with in the same manner. Several other transactions are shown in the example given, but these are self-explanatory, as they affect either :—

(*a*) The bank column only, i.e., where cheques or cash received are paid direct to the bank, being therefore recorded by means of a debit entry in that column ; or where creditors' accounts are settled by means of cheques, the amount being credited to the bank column in the cash book.

(*b*) The cash column only, i.e. where cash received is retained for use in the office, and is therefore debited

Dr. CASH BOOK. *Cr.*

Date.	Particulars.	Led. Fo.	Office Cash.	Bank.	Date.	Particulars.	Led. Fo.	Office Cash.	Bank.
19..			£ s. d.	£ s. d.	19..			£ s. d.	£ s. d.
Jan. 1	To Balances . . .	*b/f.*	4 17 9	50 0 0	Jan. 3	By Bank	c.	75 18 4	
„ 2	„ B. (cheque) . . .		70 18 4		„ 3	„ Balances . . .	*c/d.*	7 0 11	125 18 4
„ 2	„ C. (cash) . . .		7 3 2						
„ 3	„ Office Cash . . .	c.		75 18 4					
			£82 19 3	£125 18 4				£82 19 3	£125 18 4
19.. Jan. 4	To Balances . . .	*b/d.*	7 0 11	125 18 4					

In the ledger folio columns, the letter "c" (contra) is used to indicate that the equivalent debit (or credit) entry is to be found on the opposite side of the cash book. The abbreviations "c/d" and "b/d" may also be used for "carried down" and "brought down" respectively. The abbreviation "b/f" indicates that the amount is "brought forward" from the previous page, while "c/f" indicates that the amount is carried forward to the next page.

in the cash column ; or where money is paid out from office cash, the entry being credited in that column.

EXAMPLE.

On 1st January, a trader had cash in hand amounting to £32 10s., and a balance to his credit at the bank of £625 5s. Write up the following transactions in his Cash Book, and show the balances of cash in hand and at the bank on 31st January.

19..

Jan. 3. Received remittance of £56 10s. from A. Brown.
„ 4. Received cash from W. Knight & Co., amounting to £20.
Paid W. Phillips & Co.'s account of £72 by cheque, deducting 5% cash discount.
„ 5. Paid £50 into the bank.
„ 6. Paid wages, £25, by cash.
„ 11. Paid Burns Bros.' account of £22 by cheque, deducting $2\frac{1}{2}$% discount.
„ 12. Received £75, less 5% discount, from W. Lane, and banked the amount.
„ 13. Cashed a cheque for £30, and paid wages, £25, by cash.
„ 15. Received cheque for £50, less 5% discount from B. Smith, and paid it into the bank.
„ 18. Received £85 10s. from W. Berry & Co., and allowed them £4 10s. cash discount. The cheque was paid into the bank forthwith.
„ 19. Paid the account of Office Supplies Co., £6 15s. net, by cash.
„ 20. Received cash, £16, less $2\frac{1}{2}$% discount from Jones Bros.
„ 20. Paid wages, £25, in cash.
„ 24. Paid James Bros.' account of £55 by cheque, after deducting 5% discount.
„ 25. Received from W. Smith & Co., £142 10s., and paid the amount into the bank. Cash discount of £7 10s. was allowed.
„ 27. Cashed a cheque for £30, and paid £25 of the proceeds in wages.

(*See page* 67.)

This three-column form of cash book is still met with, but the method more generally adopted in practice is to bank *all cash and cheques each day* as received and to make all payments by cheque, except in the case of small amounts, which are passed through a Petty Cash Book as explained on pages 75-78. When this method is adopted, the form of cash book shown on page 69 is used. It will be seen that this cash book is similar to the ordinary three-column cash book illustrated on page 67, except that the two "cash" columns are dispensed with, their place being taken by an "Amount Received" column on the debit side and a "Details" column on the credit side.

Each cash receipt is entered first in the "Amount Received" column, and only the total amount actually banked for the day is extended into the "Bank" column. This has the advantage of keeping the latter free from unnecessary detail, and of facilitating the comparison of the Cash Book with the Bank Pass Book (or bank statements), as the total amounts entered in the "Bank" column of the former correspond with the daily "paying-in" totals in the latter. Furthermore, as all receipts are paid direct into the bank, the clerical labour of making contra entries to record transfers between office cash and bank is avoided.

The "Details" column on the credit side of the Cash Book is mainly used to record the analysis of cheques drawn for office purposes (e.g., where a cheque for £100 is drawn in respect of

THREE-COLUMN CASH BOOK.

[SHOWING DISCOUNT, CASH AND BANK ITEMS.]

Dr. *Cr.*

Date.	Name of Account.	Led. Fo.	Discount.	Cash.	Bank.	Date.	Name of Account.	Led. Fo.	Discount.	Cash.	Bank.
19			£ s. d.	£ s. d.	£ s. d.	19..			£ s. d.	£ s. d.	£ s. d.
Jan. 1	To Balances .	b/f.		32 10 0	625 5 0	Jan. 4	By W. Phillips & Co. .		3 12 0		68 8 0
„ 3	„ A. Brown .			56 10 0		„ 5	„ Bank .	c.		50 0 0	
„ 4	„ W. Knight & Co. .			20 0 0		„ 6	„ Wages .			25 0 0	
„ 5	„ Office Cash .	c.			50 0 0	„ 11	„ Burns Bros. .		11 0		21 9 0
„ 12	„ W. Lane .		3 15 0		71 5 0	„ 13	„ Office Cash .	c.			30 0 0
„ 13	„ Bank .	c.		30 0 0			„ Wages .			25 0 0	
„ 15	„ B. Smith .		2 10 0		47 10 0	„ 19	„ Office Supplies Co. .			6 15 0	
„ 18	„ W. Berry & Co.		4 10 0		85 10 0	„ 20	„ Wages .			25 0 0	
„ 20	„ Jones Bros. .		8 0	15 12 0		„ 24	„ James Bros. .		2 15 0		52 5 0
„ 25	„ W. Smith & Co.		7 10 0		142 10 0	„ 27	„ Office Cash .	c.			30 0 0
„ 27	„ Bank .	c.		30 0 0		„ 27	„ Wages .			25 0 0	
						„ 31	„ Balances .	c/d.		27 17 0	819 18 0
			£18 13 0	£184 12 0	£1,022 0 0				£6 18 0	£184 12 0	£1,022 0 0
			Total to Dr. of Discounts Allowed A/c.						*Total to Cr. of Discounts Received A/c.*		
Feb. 1.	To Balances .	b/d.		27 17 0	819 18 0						

wages, £75, and salaries, £25, these latter figures will appear in the " Details " column.)

EXAMPLE.

On 1st January, a trader's bank balance was £856 10s. 6d. Write up his Cash Book from the following particulars, and bring down the balance as at 7th January. All receipts were paid into the bank on the same day as received.

19..

Jan. 1. Received from A. Brown & Co. a cheque in payment of an account for £20, less $2\frac{1}{2}\%$ cash discount.
Received from F. Smith a cheque for £25, less 5% discount.
Received from Dewar Bros. a cheque for £24, less $2\frac{1}{2}\%$ discount.
Paid Robinson Bros.' account of £25 by cheque, after deducting cash discount of 5%.

" 2. P. Green, a customer, paid his account of £48, deducting a cash discount of £1 4s.
Received a Money Order for £24 7s. 6d. from A. Jones, in settlement of his account. A cash discount of 12s. 6d. was allowed.
Paid Jackson & Co., Ltd., a cheque for £50 on account.
Cashed a cheque for £203 17s. 6d., and paid wages £148 17s. 6d. and salaries £55 with the proceeds.

" 5. Received £100 on account from S. Johnson.

" 6. Paid Rent by cheque, £18.

" 7. Received from Fletcher & Sons a remittance of £47 10s., and allowed discount of £2 10s.
Received cash from Robertson & Co., £10, less $2\frac{1}{2}\%$ discount.
Cashed a cheque for £10, and handed the proceeds to the petty cashier for miscellaneous expenses. (*See page* 69.)

Reconciliation of the Bank Pass Book and the Cash Book.

The banker supplies his customer with a " Pass Book," which contains a copy of the ledger account of the customer as it appears in the banker's books. Periodically, the customer obtains this book from his banker for examination and comparison with his own cash book. As a consequence of the mechanisation of Bank Accounting, many banks have now replaced hand-written Pass Books by loose-leaf typed statements, which give particulars of all current transactions affecting the customer's account and show, in addition, the daily balance thereon.

The sheets are issued by the bank at monthly or other agreed intervals, and when inserted in the binding case supplied by the bank, they provide the customer with a continuous and permanent record of his account. The statements are in the following or similar form :—

R. JONES IN ACCOUNT WITH THE NORTHERN BANK, LIMITED.

Date.	Cheques, etc., paid.	£	s.	d	Credits.	£	s.	d.	Balance. £	s.	d.
Jan. 1 19..					Balance forward	300	0	0	300	0	0
					Cash . .	2	0	0	302	0	0
Jan. 8 19..	Self . .	25	0	0							
	Cheque Book	0	5	0							
	Gas Co. .	9	8	0					267	7	0
Jan. 9 19..	Smith & Co. .	10	0	0	Cash . .	15	0	0	272	7	0

N.B.—The final amount in the Balance Column is the customer's present balance according to the books of the bank. Overdrawn Balances are normally shown in red.

THREE-COLUMN CASH BOOK

Dr. [Generally used when all Receipts are Banked Daily, and all Payments are made by Cheque.] *Cr.*

19..		Led. Fo.	Discount.	Amount received.	Daily total paid into Bank.	19..		Led. Fo.	Discount.	Details.	Cheques drawn.
			£ s. d.	£ s. d.	£ s. d.				£ s. d.	£ s. d.	£ s. d.
Jan. 1	To Balance .	*b/f.*			856 10 6	Jan. 1	By Robinson Bros. .		1 5 0		23 15 0
	„ A. Brown & Co. . .		10 0	19 10 0		„ 2	„ Jackson & Co., Ltd. .				50 0 0
	„ F. Smith .		1 5 0	23 15 0			„ Wages .			148 17 6	
	„ Dewar Bros.		12 0	23 8 0	66 13 0		„ Salaries .			55 0 0	203 17 6
„ 2	„ P. Green .		1 4 0	46 16 0		„ 6	„ Rent. .				18 0 0
	„ A. Jones .		12 6	24 7 6		„ 7	„ Petty Cash	P.C. Bk.			10 0 0
					71 3 6	„ 7	„ Balance .	*c/d.*			845 19 6
„ 5	„ S. Johnson			100 0 0	100 0 0						
„ 7	„ Fletcher & Sons .		2 10 0	47 10 0							
	„ Robertson & Co. . .		5 0	9 15 0	57 5 0						
			£6 18 6		£1,151 12 0				£1 5 0		£1,151 12 0
Jan. 8	To Balance	*b/d.*			845 19 6						

Note.—When only one amount is received and banked on any day, the amount received can be entered direct in the "Bank" column without an entry in the "Amount received" column. For example, the item of £100 0s. 0d. on Jan. 5 could be omitted from the "Amount received" column.

It is rarely found that the bank balance agrees with the cash book balance, the disagreement being due to one or more of the following causes :—

(1) Cheques received and paid into the bank not credited in the pass book at the date of reconciliation.
(2) Cheques drawn and paid to creditors not presented for payment until after the date of reconciliation.
(3) Bank charges for commission, etc., entered in the pass book but not appearing in the cash book.
(4) Bank interest allowed or interest on overdrafts shown in the pass book but not entered in the cash book.
(5) Errors in the cash and/or pass book.

In order to agree the balances shown on the pass book and the cash book a Bank Reconciliation Statement must be drawn up. Before this is done the Pass Book should be examined and all items of bank interest, charges and commission must be entered in the Cash Book. A statement can then be prepared by taking the balance as shown by the pass book and *adding* thereto any items paid in but not yet credited and *deducting* any cheques drawn but not yet presented for payment. The following example will illustrate the method adopted :—

Dr. CASH BOOK. *Cr.*

		Bank.			Bank.
19..		£ s. d.	19..		£ s. d.
June 30	To Total debits . .	7,650 10 6	June 30	By Total credits . .	6,533 1 3
„ 30	„ Bank Interest for half-year to date	62 5 0	„ 30	„ Bank charges for half-year to date	59 4 3
			„ 30	„ Bank charges for cheque book .	6 0
			„ 30	„ Balance *c/d*. . .	1,120 4 0
		£7,712 15 6			£7,712 15 6
July 1	To Balance *b/d*. .	1,120 4 0			

BANK RECONCILIATION STATEMENT—30TH JUNE 19...

	£ s. d.	£ s. d.
Balance as per Pass Book		1,341 1 6
Add Cheques paid in but not credited at 30th June 19.. :—		
R. Robinson	250 12 0	
B. Smithley	100 7 0	
		350 19 0
		1,692 0 6
Less Unpresented Cheques :—		
S. Jackson	361 5 0	
R. Peters	210 11 6	
		571 16 6
Balance as per Cash Book		£1,120 4 0

If the bank account happens to be overdrawn the procedure will be reversed ; cheques paid in but not yet credited will reduce the overdraft when they are credited and hence must be *deducted* from the pass book balance, while cheques issued by the business but not yet presented will increase the overdraft and must therefore be *added* to the balance as shown by the pass book.

The term "Bank Reconciliation Account" is sometimes used, and this implies that the statement is shown in debit and credit form in the following manner :—

Dr. BANK RECONCILIATION ACCOUNT. *Cr.*

19..		£	s.	d.	19..		£	s.	d.
June 30	To Balance as per Pass Book . .	1,341	1	6	June 30	By Cheques issued but not presented :			
	„ Cheques paid in and not credited :					S. Jackson .	361	5	0
	R. Robinson .	250	12	0		R. Peters .	210	11	6
	B. Smithley .	100	7	0	„ 30	„ Balance as per Cash Book . .	1,120	4	0
		£1,692	0	6			£1,692	0	6

Alternatively, the reconciliation may be effected by working from the Cash Book balance to the Pass Book balance, in which case the procedure set out above will be reversed, viz. :—

	£	s.	d.
Balance as per Cash Book	1120	4	0
Less Cheques paid in but not credited	350	19	0
	769	5	0
Add Unpresented cheques	571	16	6
Balance as per Pass Book	£1341	1	6

These reconciliation statements or accounts may be filed or preserved in any convenient manner, but they are usually written in the Cash Book (in red ink) so that a permanent record of the outstanding items may be obtained.

If, when the Bank Reconciliation Statement (or Account) has been prepared on the lines indicated above, the final balance as shown by this statement differs from the balance in the Cash Book (after adjusting bank charges, etc.), it is apparent that an error (or errors) has been made in the writing up of the Cash Book and/or Pass Book. In order to locate such error or errors the following steps should be taken as and from the date of the last agreed reconciliation statement :—

(*a*) Cheques paid in but not credited and cheques not presented, as shown in the current Bank Reconciliation Statement, should be checked to see that they are in order.

(*b*) As it is possible for a cheque drawn in a previous period to be still unpresented at the date of the Reconciliation Statement under review, the previous Reconciliation Statement should be examined to see that all cheques shown therein as being unpresented have since been presented for payment *or* are shown in the present Reconciliation Statement as still being unpresented.

(*c*) Balances brought forward in Cash Book and Pass Book should be checked.

(*d*) The Cash Book should be searched for a payment (or receipt) equal to the amount of the error. An amount may have been recorded as paid (or received) in the bank column of the Cash Book and for some reason or other is not recorded in the Pass Book.

(*e*) The Bank Pass Book should be examined for a receipt (or payment) equal to the amount of the error. An amount may have been paid into (or out of) the bank and not entered in the Cash Book.

(*f*) Casts of Cash Book and Pass Book should be checked.

If the above checks do not reveal the error :—

(*g*) All entries in the Cash Book must be compared in detail with the entries in the Pass Book.

Whether the search should be confined to payments equal to the amount of the error or receipts equal to the amount of the error will, of course, depend on the nature of the error, *i.e.*, whether the Cash Book balance as disclosed by the Reconciliation Statement exceeds the actual balance in the Cash Book or *vice versa*.

Post-dated Cheques.

Post-dated cheques are cheques bearing a date later than the date on which they are drawn. They cannot be cashed until the date named thereon and if they are paid into a bank for collection before this date the normal procedure is for the banker to return them to safeguard himself.

In practice is it sometimes found that traders who are temporarily short of cash resources, and who are being worried by certain creditors for the settlement of their accounts, forward to these creditors cheques dated (say) one month later than the date on which they are drawn, knowing that they will, in all probability, be in a position to meet the cheques when presented at the bank for payment on the dates mentioned thereon.

In the books of the payee it is necessary for some special provision to be made for these post-dated cheques. As they cannot be paid into the bank for collection until the actual date named thereon, they should not be entered in the Cash Book

until this date. In practice one of the following methods of keeping a record of these cheques is usually adopted :—

(1) When a post-dated cheque is received it is recorded in a memorandum book (not forming part of the double entry system) and a note is made of the receipt thereof in the personal account of the debtor. No further entries are made on this date, the person forwarding the cheque being regarded, for book keeping purposes, as a debtor for this amount until the actual date on the cheque The cheque should be presented at the bank on its due date and the bank column of the Cash Book should then be debited and the personal account of the debtor credited with the amount thereof. When the cheque is entered in the Cash Book the entry in the memorandum book should be marked to indicate that the item has now been recorded in the ordinary books of account.

(2) An alternative method which is sometimes used is to open a "Post-dated Cheques Account" in the Ledger. When a post-dated cheque is received it is debited to "Post-dated Cheques Account" and credited to the personal account of the debtor forwarding the cheque. The cheque is presented for collection at the bank on the date mentioned thereon and the bank column of the Cash Book should then be debited and "Post-dated Cheques Account" credited with the amount thereof. If this method is used the balance on "Post-dated Cheques Account" at the end of a period should be treated as "debtors" and not as a "cash balance" in the Balance Sheet.

The following example illustrates this latter method :—

Dr. J. BROWN *Cr.*

19..			£	19..			£
Sept. 30	To Balance . .	b/d	150	Oct. 4	By Post-dated Cheques Account . .		100
				Dec. 31	„ Balance . .	c/d	50
			£150				£150
19..							
Jan. 1	To Balance . .	b/d	50				

Dr. H. BARBER *Cr.*

19..			£	19..			£
Sept. 30	To Balance . .	b/d	45	Nov. 11	By Post-dated Cheques Account . .		45

Dr. S. SMALLEY *Cr.*

19..			£	19..			£
Sept. 30	To Balance . .	b/d	75	Dec. 20	By Post-dated Cheques Account . .		35
				„ 31	„ Balance . .	c/d	40
			£75				£75
19..							
Jan. 1	To Balance . .	b/d	40				

Dr. POST-DATED CHEQUES ACCOUNT *Cr.*

19..			£	19..			£
Oct. 4	To J. Brown (dated Nov. 4) . .		100	Nov. 4	By Bank (J. Brown's Cheque) . .		100
Nov. 11	„ H. Barber (dated Nov. 30) . .		45	„ 30	„ Bank (H. Barber's Cheque) . .		45
Dec. 20	„ S. Smalley (dated Jan. 20) . .		35	Dec. 31	„ Balance . .	c/d	35
			£180				£180
19..							
Jan. 1	To Balance . .	b/d	35	Jan. 20	By Bank (S. Smalley's Cheque) . .		35

NOTE.—If a Balance Sheet is prepared at 31st December, 19.. the balance on "Post-dated Cheques Account" at that date (£35) should be included with "Debtors" therein.

Dr. CASH BOOK (EXTRACTS) *Cr.*

19..			Bank £	19..			Bank £
Nov. 4	To Post-dated Cheques Account . .		100				
„ 30	„ do.		45				
Jan. 20	„ do.		35				

In the books of the drawer it is also necessary to make some special provision for any post-dated cheques which he sends to his creditors. He cannot prudently regard these amounts as having been paid until the actual dates named on the cheques, and should not, therefore, enter them in his Cash Book until these dates. Methods which the drawer may adopt for recording these post-dated cheques are set out below. It should be noted that they are very similar to those described above for the payee.

(1) When a post-dated cheque is sent to a creditor it is recorded in a memorandum book (not forming part of the double entry system) and a note made of the dispatch thereof in the personal account of the

creditor. No further entries are made on this date, the person receiving the cheque being regarded, for book-keeping purposes, as a creditor for this amount until the due date of the cheque. On its due date, the cheque should be brought into the ordinary double entry books—credit bank column in Cash Book and debit personal account of creditor. The entry in the memorandum book should then be marked to indicate that the item has been recorded in the ordinary books of account.

(2) An alternative method is to open a " Post-dated Cheques Account " in the Ledger. This account is similar to the " Post-dated Cheques Account " described above for the payee, but, of course, the entries therein are reversed. When a post-dated cheque is sent to a creditor, it is credited to " Post-dated Cheques Account " and debited to the personal account of the creditor receiving the cheque. On the due date of the cheque the bank column of the Cash Book should be credited and " Post-dated Cheques Account " debited with the amount thereof. If this method is used the balance on " Post-dated Cheques Account " at the end of a period should be treated as " creditors " and not as a deduction from the " bank balance " in the Balance Sheet.

Petty Cash Expenditure.

There are various methods of dealing with small disbursements, the oldest method being to supply a clerk with a round sum out of which to make payments for such small items as may occur ; when the cash in hand is reduced to a small amount, a further sum is handed to him. The book used is ruled similarly to a ledger account, with one cash column on each side.

As this system necessitates the laborious analysis of expenditure, it has been largely superseded by a better and more efficient method, involving the use of a columnar form of petty cash book, having on the credit side analysis columns, with appropriate headings, for the more usual classes of expenditure. This method enables the petty cashier to analyse the expenditure as it occurs, carrying forward the totals from page to page until the end of the month. A separate column, headed " Ledger," is usually provided to accommodate payments relating to personal accounts and those infrequent items of expenditure for which the analysis columns provided are unsuitable. It will be obvious to the reader that the combined totals of the analysis and " ledger " columns must equal the total expenditure for the period as shown in the " total payments " column.

Dr. PETTY CASH BOOK. *Cr.*

Amount Received.	Cash Book Folio.	Date.	Details.	Voucher No.	Payments. Total.	Analysis of Payments. Sundry Expenses. (a)	Stamps & Telegrams. (b)	Stationery. (c)	Carriage. (d)	Travelling Expenses. (e)	Ledger Folio.	Ledger Accounts. (f)
£ s. d.		19..			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.		£ s. d.
20 0 0	17	Jan. 1	To Cash									
		,, 6	By Postage Stamps .	1	2 0 0		2 0 0					
		,, 10	,, Envelopes . .	2	2 10 0			2 10 0				
		,, 16	,, Empties from Jones & Co.	3	3 0				3 0			
		,, 20	,, Brown's Expenses to Leeds . . .	4	3 10 0					3 10 0		
		,, 26	,, Howe & Co. . .	5	15 0						106	15 0
8 18 0	23	,, 31	To Cash									
					£8 18 0		£2 0 0	£2 10 0	3 0	£3 10 0		15 0
		,, 31	By Balance c/d. . .		20 0 0		(23)	(30)	(36)	(14)		
£28 18 0					£28 18 0							
20 0 0		Feb. 1	To Balance b/d.									

The Imprest System.

The method of dealing with petty cash transactions which is adopted nowadays by the greater proportion of up-to-date firms is known as the Imprest System. In this system a specified sum is definitely allotted to the person in charge of the Petty Cash Book. This sum is handed to the petty cashier in the first instance, and at periodical intervals (monthly, or otherwise, as arranged) a cheque for the exact amount of petty cash disbursed for the period concerned is given to him, to bring his cash balance up to the agreed figure again. Thus at the commencement of each fresh period the balance of petty cash in hand is always the fixed " imprest " amount.

The cheques for the advances to petty cash are entered in the General Cash Book (credit side) and posted to the debit side of the Petty Cash Book. This book contains analysis columns, as indicated above, for dissecting the expenditure, and the totals of these analysis columns are posted periodically to the debit of the appropriate nominal accounts in the General Ledger, or to the personal or real accounts affected if any payments relating to such accounts are made through the petty cash. By this method, the Petty Cash Book is not only a book of original entry, but is also an essential part of the double entry book-keeping system, and the balance of petty cash on hand must therefore be included in the Trial Balance.

With the imprest method, time is saved, the risk of error is minimised, and the fact that the balance in hand never exceeds a stated amount obviates the possibility of a continuous series of defalcations being covered by the constant increase of the cash balance supposed to be in hand.

A specimen ruling of an analysis Petty Cash Book in which the Petty Cash is kept on the Imprest System, is shown on page 76.

In the example given, the sum of £8 18s. has been credited in detail to the petty cash book during January, and the double entry is obtained by posting the totals of the petty cash book analysis columns (*a*) to (*e*) and the details of column (*f*) to the debit of the proper ledger accounts, the folios of the ledger accounts being entered against the appropriate items as indicated.

The following summary will make this clear :—

		£	s.	d.	£	s.	d.
Stamps and Telegrams Account	*Dr.*	2	0	0			
Stationery Account . . .	,,	2	10	0			
Carriage Account . . .	,,		3	0			
Travelling Expenses . .	,,	3	10	0			
Howe & Co.'s Account . .	,,		15	0			
To Cash					8	18	0
		£8	18	0	£8	18	0

It should be observed that the Petty Cash " Book " is not kept on the imprest system—it is the Petty Cash which is so kept. The

analysis method of making entries in the Petty Cash Book is quite separate and distinct from the imprest system of keeping the cash, and each may be adopted independently of the other, though it is usual to combine them in the recording of Petty Cash.

In many firms the petty cashier is not allowed to initiate payments on his own responsibility, but is allowed to make disbursements only against vouchers duly signed by a responsible person. The voucher may be in the following or some similar form :—

PETTY CASH VOUCHER

No. *107*. *29th Dec., 19....*

ACCOUNT TO BE DEBITED *Postages and Telegrams......*

...*Three*...pounds......shillings and......pence...for

2½d. postage stamps..................................

Authorised by

£3 : - : - *K. Jones.*

Received by.........*T. Smith*....................

A Reconciliation Statement of the contents of the petty cash box with the balance shown in the petty cash book is prepared in the following manner as occasion requires :—

					£	s.	d.
19..							
Jan. 31.	Balance as per Petty Cash Book . .				20	0	0
	Contents of Box—						
		£	s.	d.			
	£1 Notes	10	0	0			
	10s. Notes	5	0	0			
	Silver	4	16	6			
	Copper		3	6			
					£20	0	0

Where the "voucher" system is utilised in conjunction with the "imprest" system, the petty cashier should be in possession, at any given date, of unexpended cash and petty cash vouchers equivalent to the fixed "imprest" amount.

Postages Book.

Just as the petty cash book is used to relieve the cash book of numerous small items of expenditure, so a Postages Book is employed in many offices in which to record details of expenditure on postages. The stamps are purchased in the first instance out of petty cash, the petty cashier recording the payment in the usual way and the postages clerk entering the receipt of the stamps in his postages book. Expenditure on postages will then be detailed in this book. Whilst the imprest system could be

adopted for such expenditure, this is not usual owing to the fact that the volume of expenditure varies widely over different periods. The person authorising the purchase of stamps should, however, before doing so, examine the postages book as a check against petty defalcations. The postages book is not usually regarded as part of the double entry system.

Columnar Cash Books (Advanced Type).

With businesses of any magnitude, it becomes necessary to apply the principle of subdivision to the cash book, the most usual example being the provision of separate books for receipts and payments. These books may be again subdivided ; thus, as will be explained later, there may be several sales ledgers and two or more purchases ledgers, in which case the cash books will be provided with analysis columns for the postings to the different ledgers. Examples of this type of cash book are shown on page 80.

A method frequently adopted involves the use of two cash books, one of which is entered up on Mondays, Wednesdays and Fridays, and the other on Tuesdays, Thursdays and Saturdays, the ledger-keeper posting from the cash book not in use on the day following that on which the entries are made. Such a method is not only very convenient, but it also adds much to the efficiency of the book-keeping system.

Dr. GENERAL SUMMARY CASH BOOK. *Cr.*

19..			£	s.	d.	19..			£	s.	d.
Jan.	1	To Balance *b/f.*	1,220	10	6	Jan.	1	By Sundries as per Paid Cash Book	994	5	0
"	1	Sundries as per Received Cash Book	130	18	0	"	2	" do. do.	216	7	6
						"	3	" do. do.	300	10	0
"	2	" do. do.	520	12	6	"	4	" do. do.	640	12	6
"	3	" do. do.	608	7	6			etc.	etc.		
"	4	" do. do.	416	5	0	"	31	" Balance *c/d.*	1,320	16	3
		etc.	etc.								
			£15,260	15	6				£15,260	15	6
Feb.	1	To Balance *b/d.*	1,320	16	3						

Each day's total of receipts or payments is separately shown in the Received or Paid Cash Book in the columns provided, and is then transferred to a General Summary Cash Book, a specimen ruling of which is given above. The entries on each page of the Received or Paid Cash Books are totalled and are carried forward from page to page until the end of the period, when a final total for the period is made. It will be obvious that the combined totals of the Received Cash Book will equal the total debit entries transferred to the General Summary Cash Book, and the same applies to the total of the Paid Cash Book.

Where more than one subsidiary cash book is used on each day it is usual to provide a two-columned General Summary

RECEIVED CASH BOOK.

(COLUMNAR FORM.)

Dr.

Date.	Account and Particulars.	Receipt No.	Discount.	Individual Amounts.	Daily Totals.	Fo.	Sales Ledger A—L.	Fo.	Sales Ledger M—Z.	Fo.	Bought Ledger.	Fo.	General Ledger.
			£ s. d.	£ s. d.	£ s. d.		£ s. d.		£ s. d.		£ s. d.		£ s. d.
19.. Jan. 1	To A. Brown	17	7 6	7 2 6		93	7 10 0						
„ 1	„ J. Smith	18	4 6	8 15 6				82	9 0 0				
„ 1	„ Cox & Co. (amount overpaid refunded)	19		100 0 0						16	100 0 0		
„ 1	„ Furniture A/c. (Desk sold)	20		15 0 0	130 18 0							92	15 0 0
„ 2	„ Roberts & Sons . .	21	2 2 6	40 7 6				19	42 10 0				
		(a)	(b)	(c)	(d)		(e)		(f)		(g)		(h)

Notes.—(a) This column is used to record the receipt number shown in the counterfoil receipt books.
(b) and (c) The individual amounts relating to each item are entered in these columns.
(d) The total of each day's receipts (exclusive of discounts) is entered in this column.
(e) to (h) The combined total of cash and discount is entered in these columns. A separate folio column is provided for each ledger to facilitate checking.

PAID CASH BOOK.

(COLUMNAR FORM.)

Cr.

Date.	Account and Particulars.	Voucher No.	Discount.	Individual Amounts.	Daily Totals.	Fo	Bought Ledger A—L.	Fo	Bought Ledger M—Z.	Fo	Sales Ledger	Fo	Nominal Ledger.	Fo	General Ledger.
			£ s. d.	£ s. d.	£ s. d.		£ s. d.		£ s. d.		£ s. d.		£ s. d.		£ s. d.
19.. Jan. 1	By Arthur & Co. .	1	19 0	18 1 0		7	19 0 0								
„ 1	„ Merchant & Co. (allowance) .	2		13 15 6						18	13 15 6				
„ 1	„ Wages . . .	—		62 8 6								19	62 8 6		
„ 1	„ Solicitor & Co. (land bought)	3		900 0 0	994 5 0									6	900 0 0
„ 2	„ Warwick & Co., Ltd. . . .	4	7 0	6 13 0		8	7 0 0								
		(i)	(j)	(k)	(l)		(m)		(n)		(o)		(p)		(q)

Notes.—(i) This column is used to record the consecutive voucher number inserted on the receipted accounts.
(j) and (k) The individual amounts relating to each payment are entered in these columns.
(l) The total of each day's payments (exclusive of discounts) is entered in this column.
(m) to (q) The combined total of cash and discount is entered in these columns, a separate folio column being provided for each ledger.

Cash Book, the daily totals from each subsidiary book being entered in the first column and the final total for the day entered in the second column, or where possible a separate column is provided for each subsidiary book, and the total entered in the final column.

EXERCISE 3.

A. From the following particulars write up the Cash Book (Bank and Discount columns), and the Petty Cash Book of Messrs James & Pilgrim. All receipts were paid to the Bank as received, and all payments made by cheque except where otherwise stated.

19..			£	s.	d.
July	1.	Cash at Bank, Current Account	487	2	6
		Petty Cash in hand	12	15	6

„ 5. M. Grove paid account to date, £520, less 3¾% discount.
„ 7. Drew cheque for Petty Cash, £40.
Paid to Bank, Cash Sales for week, £93 5s. 8d.
„ 12. Purchased and paid for a Roll Top Desk, price £50.
Paid B. Savory the amount standing to his credit at July 2nd, £431 10s., less 2½% discount.
„ 14. Drew cheque for Petty Cash, £35.
„ Paid to Bank, Cash Sales for week, £125 10s. 6d.
„ 18. Paid L. Smith the amount of his account, £98 7s. 6d.
„ 20. Sold for cash, at valuation at last stock-taking, old Office Desk for £12 10s., and 3 Office Stools at 5s. each, and paid proceeds into Bank.
Purchased and paid for a second-hand Typewriter, £28.
„ 21. Drew cheque for Petty Cash, £40.
Paid to Bank, Cash Sales for week, £143 17s. 6d.
„ 23. Transferred from Deposit A/c. to Current A/c., £500.
Advanced to E. Hammans on loan at 10% per annum the sum of £1,000.
„ 26. Received cheque from London Trading Co., £425.
„ 28. Drew cheque for Petty Cash, £40.
Paid to Bank, Cash Sales for week, £138 19s.
Drew cheques :—

P. James	£150
E. Pilgrim	100

„ 28. The Petty Cash payments to date were :—

	£	s.	d.
Wages	78	10	0
Trade Expenses	24	12	9
Repairs to Building	25	0	0
Travelling	15	2	8

„ 30. Paid from Petty Cash for Odd Garments, £19 10s.

B. From the following particulars write up the Cash Book and the Petty Cash Book of James Plummer.

19..			£	s.	d.
Jan.	1.	Cash at Midland Bank	232	10	3
		Petty Cash in hand	14	0	0

All payments were made by cheque unless otherwise stated.
All receipts were paid to the Bank.
„ 3. Drew cheque for Petty Cash, £35.
5. Received from H. Edwards cheque in settlement of his account, £326, less 5% discount.
Paid S. Hitchin's account, £259, less discount, 3¾%.
Sold for cash 100 boxes Raisins at 10s. 6d. box.

19..
Jan. 8. Transferred to Current Account from Deposit Account, £500.
Paid account of R. Davis, £741, less discount $2\frac{1}{2}$%.
" 10. Drew cheque for Petty Cash, £40.
" 16. Paid cheque for Petrol and Motor Repairs, £44 15s.
" 17. Drew cheque for Petty Cash, £38 10s.
" 23. Sold for cash 30 boxes of Eggs at 50s. box.
" 24. Drew cheque for Petty Cash, £40 10s.
" 27. Sold for Cash, odd lots amounting to £200
" 31. Drew cheque for Petty Cash, £42.
Drew cheque, personal drawings, £50.
Payments from Petty Cash during the month were :—

	£	s.	d.
Salaries and Wages	89	6	2
Trade Expenses	17	14	3
Sundry Purchases	93	12	9

C. From the following transactions of Jonathan Brown write up his Cash Book (three-column form; Discount, Office Cash and Bank), bringing down the balances.

19..			£	s.	d.
Jan.	1.	Cash at Bank,	520	0	0
		Drew cheque for Office Cash	30	0	0
"	2.	Received cheque from William Watts	194	13	4
		Discount in addition	5	6	8
"	3.	Postages and telegrams—Office Cash	1	15	6
"	4.	Carriage paid from Office Cash	2	3	4
"	8.	Paid James Hill by cheque	143	10	0
		Discount in addition	2	2	6
"	10.	Received John Gray's cheque	356	19	6
"	11.	Posted cheque to James Hill	100	0	0
		Paid Wages from Office Cash	7	17	6
"	15.	Received John Gray's cheque	150	8	4
"	16.	Donation to Red Cross—Office Cash	1	1	0
"	18.	Paid Henry Gates by cheque	201	10	0
		Discount in addition	3	12	6
"	21.	Received cheque from Thomas Monk	214	3	4
		Discount in addition	5	16	8
"	22.	Drew cheque for Henry Gates	120	0	0
"	24.	Cab fares—Office Cash	1	7	6
"	25.	Paid Wages—Office Cash	7	17	6
"	27.	Received Thomas Monk's cheque	98	6	2
"	28.	Drew cheque for Joseph Johns	78	15	0
		Discount in addition	1	10	0
"	30.	Drew cheque for Joseph Johns	135	10	0
		Drew cheque for self	20	0	0
"	31.	Paid Salaries by cheques	30	0	0

D. Write up a Bank Account recording the following transactions :—1st December 19.., balance at my Bank, £3,215 14s. 1d. 2nd December, drew cheque for self, £25. 4th December, paid in £9,634 received from W. Porter. 6th December, drew cheque for T. Kerr, £161 10s. 6th December, E. Milner paid into my Bank Account, £864. 10th December, drew cheque for J. Coleman, £10,000. 15th December, drew cheque for Black and White. £241 6s. 3d. 24th December, drew cheque £50 for rent, and paid into Bank, £91 6s. 8d. received from H. Jackson. 31st December, drew cheque £25 for self. Paid into Bank £51 received from Duff Bros. Interest allowed on the account by the Bank, £18 9s. 3d., and commission charged, £1 2s. 3d. Close the account and bring down the balance.

E. From the following particulars compile the Cash Book of Arthur Williamson showing Cash, Bank and Discount columns and bring down the balances.

19..			£	s.	d.
Mar.	1.	Balance at Bank	2,000	0	0
		Purchased a Stock of Goods by cheque	1,000	0	0
		Drew cheque for Office Cash	40	0	0
		Purchased Stationery from Office Cash	5	7	6
,,	8.	Received John Dale's cheque	123	10	6
		Discount in addition	3	15	4
,,	9.	Received Thomas Fry's cheque	140	2	3
		Discount in addition	5	10	3
,,	10.	Carriage paid from Office Cash	2	4	10
,,	12.	Received cheque from Henry Gage	180	0	0
		Discount in addition	4	10	0
,,	13.	Paid Wages—Office Cash	9	12	6
		Drew cheque for Walter Uden	193	17	6
		Discount in addition	6	2	6
,,	15.	Received John Dale's cheque	67	9	1
		Paid Carriage from Office Cash	2	12	2
,,	17.	Drew cheque for Walter Uden	100	0	0
,,	19.	Received James Hart's cheque	184	3	4
		Discount in addition	6	3	4
,,	20.	Postages, &c.—Office Cash	2	17	6
		Paid Joseph Vine by cheque	152	7	6
		Discount in addition	5	8	0
,,	22.	Received Thomas Fry's cheque	73	5	3
,,	24.	Paid for Cleaning from Office Cash	1	16	6
		Drew cheque for Arthur Young	120	3	4
,,	27.	Paid Wages—Office Cash	10	8	4
,,	30.	Drew cheque for Self	30	0	0
,,	31.	Drew cheque for Salaries	25	0	0

F. Enter the following transactions in William Chown's Cash Book, showing Discount, Office Cash and Bank columns.

19..

Jan. 1. Balance at Bank £341 10s.
Drew and cashed cheque for £100 for Office Cash.
Bought for cash 16 Paris model ladies' coats for £47.

,, 3. B. Bryce paid, by cheque, £50 on account. Paid cheque into Bank.

,, 5. Sold, for cash, two costumes at £6 and £5 10s. respectively.
Paid, in cash, Wages £12, and Office Expenses, £2 1s.

,, 9. Paid, by cheque, M. Herriott's account, £129, less $2\frac{1}{2}\%$ discount.

,, 10. Cash sales to date £38.

,, 12. Paid, by cheque, H. Dickson's account, £150.
Paid Wages, in cash, £14, and Office Expenses, £3 4s.

,, 14. Paid, in cash, Carriage, £8 6s.

,, 15. Paid, by cheque, B. Bryce's account, £62.

,, 16. Gave M. Herriott a cheque on account, £50.

,, 17. Cash sales for week, £92.

,, 20. Wm. Chown drew cheque, £50, for private purposes.
G Dawson paid £125 by cheque. Paid cheque into Bank.

,, 21. Purchased, for cash, 8 dozen coat hangers at 24s. per dozen. (Charge to Furniture and Fixtures Account.)
B. Bryce paid £100 on account by cheque. Paid cheque into Bank.

,, 22. Paid cash into Bank £100.

G. On the 1st January, 19.., the position of John Taylor, Manufacturer was as follows :—

Assets :—

Stock on hand, £5,420; plant and machinery, £4,000; leasehold property, £3,000; debtors, £2,870 (J. Hogan, £400; P. Craven, £200; T. Dickie, £420; J. Littlejohn, £300; A Graham, £600; N. Lynch, £200; J. Henderson, £400; L. MacIntosh, £350); petty cash, £60.

Liabilities :—

Sundry creditors, £2,950 (Hardy Bros., £950; J. Forrest, £320; Little & Co., £620; Carter & Co., £410; Cummins & Co., £150; Brown & Co., £500); overdraft at bank, £1,750.

Open the books and enter the following transactions into subsidiary books. —Post to the Ledger, and extract Trial Balance. Taylor pays all his receipts direct into the Bank, and pays everything by cheque.

19..

Jan. 3. Received J. Hogan's cheque, £380—discount, £20.
,, 4. Sold P. Craven, goods, £200.
,, 5. Dispatched credit note to T. Dickie, for goods returned, £70.
Paid wages and salaries, £200.
,, 6. Received P. Craven's cheque, £190—discount, £10.
,, 7. Received A. Graham's cheque for balance of account, £595—discount £5,
,, 9. Paid Little & Co. cheque for balance of account, £620.
,, 10. Bought of Cummins & Co., goods, £700.
,, 12. Drew out for personal expenses, £100. (*Dr.* Drawings, *Cr.* Bank.)
,, 13. Paid Wages and Salaries, £150.
,, 14. Cash received for ready money sales, £20
Sold J. Henderson, goods, £500.
Received J. Henderson's cheque, £380—discount, £20
,, 16. Received credit note from Cummins & Co., in respect of goods over priced, £50.
,, 17. Paid Cummins & Co., £95—discount, £5.
,, 19. Received N. Lynch's cheque, £190—discount, £10.
Sold A. Graham, goods, £650.
,, 20. Paid Carter & Co. cheque, £410.
Paid Brown & Co. cheque, £500.
Paid Wages and Salaries, £120.
,, 21. Cash received for ready money sales, £30.
,, 23. John Taylor paid in further capital, £527 10s.
Received T. Dickie's cheque, £333—discount, £17
Received J. Littlejohn's cheque, £285—discount, £15.

H. On 31st December the Cash Book showed a balance of £1,500 as Cash at Bank, but the Bank Pass Book made up to the same date showed that cheques for £70, £90, and £100 respectively had not been presented for payment; also cheques to the amount of £210 paid into the account had not yet been cleared. Find by means of a Reconciliation Statement the balance shown in the Pass Book.

I. What do you understand by a Bank Reconciliation Statement? Prepare one with imaginary figures to illustrate your answer.

J. What do you understand by the Imprest System as applied to Petty Cash? Give a suitable ruling for a Petty Cash Book. Illustrate with six specimen entries.

K. To illustrate the Imprest System of petty cash, make out in columnar style a model Petty Cash Book with an imprest of £20 and payments amounting to £15 during the month, then balance the book.

L. On 1st January, 19.. a cheque for £40 was handed to the petty cashier to meet disbursements for the month, which were as follows:—

19..		£	s.	d.
Jan. 1.	Postage Stamps	5	0	0
	Carriage		15	6
	Telephone			2
„ 2.	Envelopes	1	2	6
	Fares		4	6
	Toilet Soap		2	0
„ 3.	Postage Stamps	5	0	0
	Trunk Call		3	9
„ 8.	Carriage		6	9
„ 10.	Paid Edgeley & Co.'s account	2	10	0
„ 13.	Postage Stamps	5	0	0
	Shorthand Note Books		12	6
„ 18.	Telephone		1	0
	Window Cleaning		2	6
„ 22.	Carriage		3	4
	Fares		1	0
„ 25.	Postage Stamps	5	0	0
„ 27.	Envelopes	1	7	6
	Carriage	3	4	2
	Fares to Cardiff	1	17	6
	Telephone			9
„ 30.	Postage Stamps	5	0	0

You are required to prepare a Petty Cash Account in analysis form, using the Imprest System. Rule off the account at Jan. 31st, obtain a cheque from the cashier to bring the balance in hand up to the amount of the original imprest sum, and carry down the balance.

M. A client banks all cheques received, and pays wages, petty cash and sundry expenses, including his own drawings, out of the ready money takings, sometimes banking some of the latter if not required for cash payments. He pays by cheques for purchases and payments other than those mentioned. Draft a form of Cash Book with imaginary entries illustrating the method you would recommend him to adopt.

N. A trader receives a considerable number of post-dated cheques in settlement of debts. How do you consider he should deal with these in his books of account?

CHAPTER IV

THE LEDGER; ADJUSTMENTS; PREPARATION OF FINAL ACCOUNTS

THE Ledger is the book of account which contains, in a suitably classified form, the final and permanent records of a trader's transactions. For the reasons already explained, the entries are first collected together into suitable groups in books of prime entry, e.g., Cash Book, Journal, and Day Books, and are posted therefrom, either individually or in total, to the ledger accounts.

Classification of Ledger Accounts.

In the case of a small business all the ledger accounts can be accommodated in a single volume, and the whole of the postings can be effected by one book-keeper, but when transactions are extensive and the ledger accounts correspondingly numerous, it becomes necessary to divide the ledger into sections, each of which is bound into one or more separate volumes.

In carrying out such subdivision the principles of systematic classification, which were followed when expanding the journal into the Sales Day Book, Purchases Day Book, etc., are again applied. Accounts of a similar nature are grouped together into ledgers, labelled to indicate their contents. Thus the accounts of debtors are kept in a "Sales" or "Debtors" ledger, and the accounts of creditors in a "Purchases" or "Creditors" ledger.

The division of the ledgers will vary according to the nature and size of the business, but the broadest division is as follows :—

1. SALES LEDGERS, containing only accounts with customers (debtors).
2. PURCHASES LEDGERS, used to record dealings with suppliers (creditors).
3. GENERAL LEDGER, containing all other accounts. In most cases this ledger is divided into two parts :
   (a) *Impersonal Ledger*, containing both real and nominal accounts ; e.g., machinery, discounts, etc.
   (b) *Private Ledger*, containing accounts of a particularly private nature which disclose the financial standing of the business, such as capital, profit and loss, etc.

An alternative division of the General Ledger is :—

(*a*) *Nominal Ledger*, containing the nominal accounts of income and expenditure, e.g., interest receivable, wages, etc.

(*b*) *Private Ledger*, containing all accounts not included in the Personal (debtors and creditors) and Nominal Ledgers, e.g., machinery, investments, capital, profit and loss, etc.

In this book the term "General Ledger" will be used to refer to the ledgers, other than the Sales or Purchases Ledgers, however subdivided.

The chart on page 88 shows clearly the inter-relationship of the ledger (in its chief subdivisions) and the subsidiary books of prime entry. The journal, although a most important book, is excluded because the transactions passing through it are of a miscellaneous character, involving every conceivable combination of debits and credits, and affecting the whole of the ledgers.

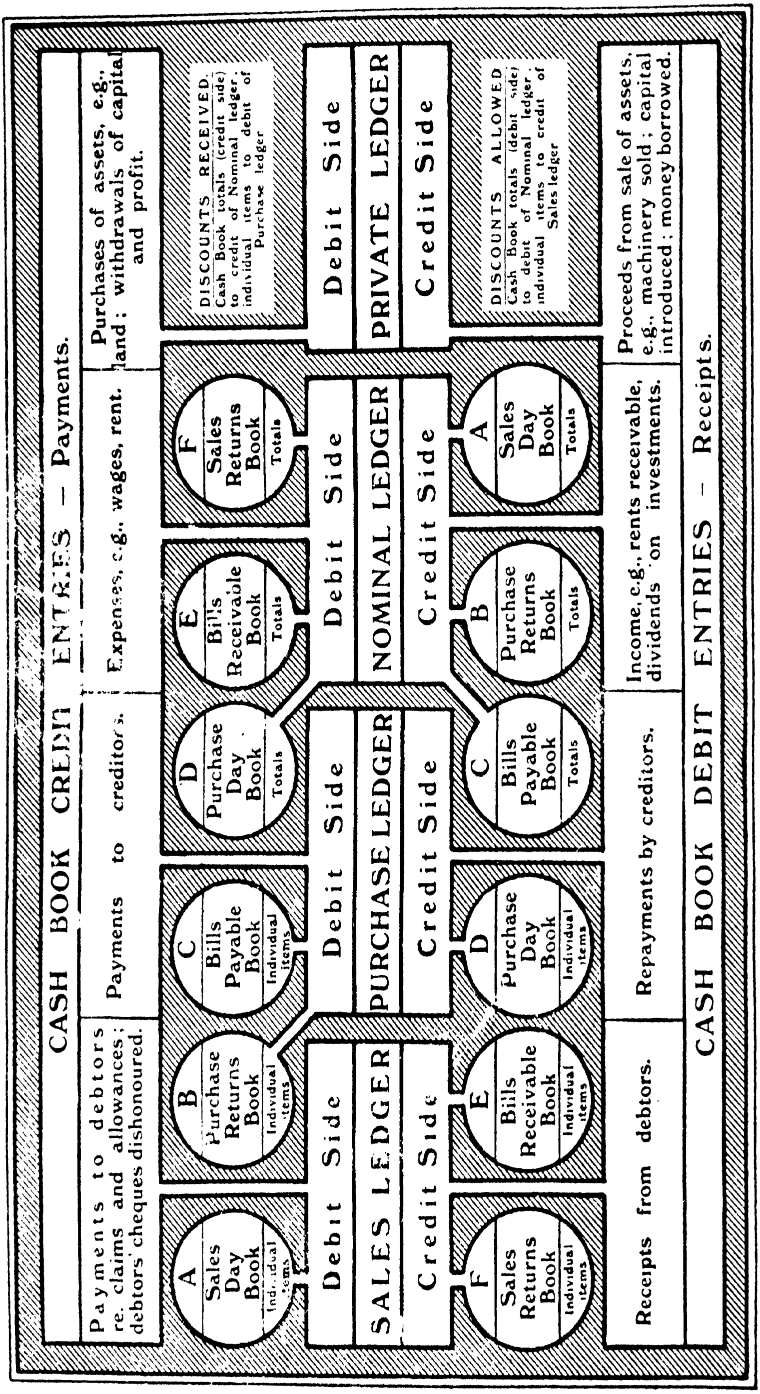
Where accounts with debtors and creditors are very numerous, the personal ledgers are still further subdivided—alphabetically, geographically or otherwise. An alphabetical subdivision into a group of three ledgers may be arranged to include respectively the accounts of persons whose names commence with the letters A to F, G to O, and P to Z. A geographical subdivision is based on a regional classification according to the addresses of the persons concerned, and the grouping may be arranged in any convenient way, e.g. :—

(1) London and home counties.
(2) Southern counties.
(3) Midland counties.
(4) Northern counties.
(5) Scotland.
(6) Foreign.

A convenient and easily-worked geographical method is to divide the country into travellers' or agents' areas, ignoring county boundaries, etc. This system is of value as it considerably reduces the labour involved in checking travellers' commissions on sales, comparing the annual volume of business received from various travellers, and obtaining other statistical information regarded as essential in up-to-date businesses.

The Nature of Entries in the Ledger.

Broadly, it may be stated that debit entries in the ledger represent either assets, expenses or losses, while credit entries


CASH BOOK CREDIT ENTRIES - Payments.
Payments to debtors re. claims and allowances; debtors' cheques dishonoured.
Payments to creditors.
Expenses, e.g., wages, rent.
Purchases of assets, e.g., land; withdrawals of capital and profit.
A Sales Day Book Individual items
B Purchase Returns Book Individual items
C Bills Payable Book Individual items
D Purchase Day Book Totals
E Bills Receivable Book Totals
F Sales Returns Book Totals
DISCOUNTS RECEIVED. Cash Book totals (credit side) to credit of Nominal ledger, individual items to debit of Purchase ledger
Debit Side
SALES LEDGER
Credit Side
Debit Side
PURCHASE LEDGER
Credit Side
Debit Side
NOMINAL LEDGER
Credit Side
Debit Side
PRIVATE LEDGER
Credit Side
F Sales Returns Book Individual items
E Bills Receivable Book Individual items
D Purchase Day Book Individual items
C Bills Payable Book Totals
B Purchase Returns Book Totals
A Sales Day Book Totals
DISCOUNTS ALLOWED Cash Book totals (debit side) to debit of Nominal ledger, individual items to credit of Sales ledger
Receipts from debtors.
Repayments by creditors.
Income, e.g., rents receivable, dividends on investments.
Proceeds from sale of assets, e.g., machinery sold; capital introduced; money borrowed.
CASH BOOK DEBIT ENTRIES - Receipts.

represent liabilities, income or profits; but if each of the three classes of ledger accounts is considered more specifically, the nature of the entries therein may be summarised as follows :—

(*a*) Personal Accounts. *A debit entry* signifies the creation of a debt due by the person whose name appears at the head of the account (e.g., a sale), or the extinction of the whole or some portion of a liability to that person (e.g., cash paid, bill payable, purchase return).

A credit entry signifies the creation of a liability to the person named on the account (e.g., a purchase), or the complete or partial extinction of some debt due by that person (e.g., cash received, bill receivable, sale return).

(*b*) Real Accounts. A *debit entry* signifies the creation or extension of an asset, e.g., purchase of buildings, plant and machinery, investments, etc.

A *credit entry* records a reduction in the book value of some asset, e.g., by sale of a portion of the asset, or writing down the book value thereof by means of depreciation.

The cash book, which is a real account separately bound, is debited with increases and credited with reductions of the balance from time to time in hand.

(*c*) Nominal Accounts. Losses or expenses are expressed by *debit entries;* profits or gains by *credit entries;* e.g., "Wages paid" appears as a debit in Wages Account; "Rents received" is credited in Rent Receivable Account.

Suspense Accounts.

A Suspense Account is a ledger account in which items in abeyance are temporarily recorded, i.e., any items which, owing to insufficient data, cannot at the time of entry be posted to their correct accounts. For example, if *A* receives £1 from his customer *B*, the entries in *A's* books would be :—

		£ s. d.	£ s. d.
Cash Account . . .	*Dr.*	1 0 0	
To *B's* Account . . .			1 0 0

But if *A* received through the post on 1st January a postal order for £1 without any indication of the sender's identity, and on 10th January he discovered that the remittance came from *B*, *A's* book-keeping entries would be :—

			£ s. d.	£ s. d.
Jan. 1.	Cash Account	*Dr.*	1 0 0	
	To Suspense Account			1 0 0
,, 10.	Suspense Account	*Dr.*	1 0 0	
	To *B's* Account			1 0 0

A Suspense Account may also be used when a difference is disclosed by the Trial Balance, the difference being debited or credited thereto pending the location of the error(s) responsible therefor. This subject is dealt with more fully later on in this Chapter (see page 109).

Personal Accounts—Bad Debts.

Examples of personal accounts are given in Chapter I, and these do not need further illustration as far as ordinary transactions are concerned. Occasionally, however, a trader incurs a "bad debt," through the failure of a customer to pay either the whole or part of an amount due from him.

When it becomes known that a debtor's balance is irrecoverable, and that it no longer represents an asset, the personal account must be closed by transferring the loss to the debit of a Bad Debts Account, in which all the bad debts are collected pending their transfer to the debit of the Profit and Loss Account at the end of the financial year.

When a debt is written off in this way, the debtor is regarded as being quite unlikely to pay the amount owing, but it sometimes happens that a turn of fortune or an unexpected distribution from the debtor's trustee results later on in the discharge either of the whole or of a part of the debt due from him. In such a case, the creditor may adopt one of two methods of recording the transaction in his books :—

(a) He may adopt the method shown in the following example, and simply post the amount received from the Cash Book to the credit of the Bad Debts Account, thereby reducing the total amount to be written off for the period ; or

(b) He may post the amount from the Cash Book to the credit of the personal account, and then by means of a journal entry transfer it to the credit of the Bad Debts Account.

The first method is the more direct, but the latter provides in the personal account concerned a record which may afford useful information at some future date, although by the first method it is usual to make a memorandum of the payment in the personal account concerned.

EXAMPLE.

On 1st January A. Royal owes the sum of £52 in respect of goods supplied. He becomes bankrupt, and his trustee pays a first and final dividend of 10s. in the £ on 1st February. Another debtor, B. Brock, has owed the sum of £24 for a considerable period, and letters requesting payment have been ignored, the last being returned marked "Gone—no address." On 4th April it is decided to write off the debt as bad, and this is done; on 17th September, however, B. Brock sends a cheque in full settlement. Enter these transactions in the Journal, Cash Book and Ledger, and close the books on 31st December.

JOURNAL.

		£	s.	d.	£	s.	d.
19..							
Feb. 1	Bad Debts Account . . . *Dr.*	26	0	0			
	To A. Royal				26	0	0
	Being bad debt written off owing to bankruptcy of debtor.						
Apr. 4	Bad Debts Account . . . *Dr.*	24	0	0			
	To B. Brock				24	0	0
	Being bad debt written off owing to fact that debtor cannot be traced.						
Dec. 31	Profit and Loss Account . . *Dr.*	26	0	0			
	To Bad Debts Account . . .				26	0	0
	Being transfer of bad debts for the year ended 31st December, 19..						

Dr. CASH BOOK (*Extracts*). *Cr.*

			£				£
19..				19..			
Feb. 1	To A. Royal .		26	Dec. 31	By Balance . .	*c/d*	50
Sep. 17	„ Bad Debt Recovered (B. Brock) .		24				
			£50				£50
19..							
Jan. 1	To Balance . .	*b/d*	50				

NOTE.—In practice there would, of course, be many other items in the Cash Book but as the question says " close the books on 31st December " the Cash Book has been balanced off on this date on the basis of the information available.

Dr. A. ROYAL. *Cr.*

			£			£
19..				19..		
Jan. 1	To Balance . .	*b/d*	52	Feb. 1	By Cash . .	26
				„	„ Bad Debts .	26
			£52			£52

Dr. B. BROCK. *Cr.*

			£			£
19..				19..		
Jan. 1	To Balance . .	*b/d*	24	Apl. 4	By Bad Debts .	24

Dr. BAD DEBTS ACCOUNT. *Cr.*

		£			£
19..			19..		
Feb. 1	To A. Royal . .	26	Sep. 17	By Cash (B. Brock)	24
Apl. 4	„ B. Brock . .	24	Dec. 31	„ Profit and Loss Account .	26
		£50			£50

In addition to writing off the debts as bad (as explained above) an entry can be made in a Memorandum Bad Debts Ledger in order to retain a permanent record of debts that have been written off. In this way such debts are available for periodical reference in the eventuality of an improvement in the affairs of the customers to which the debts relate or the location of a customer previously untraceable, thus enabling the trader to review, from time to time, the possibility of recovery of debts previously written off.

Real Accounts and their Adjustment.

Real accounts contain a record of the assets owned by a trader, being debited at the outset with the cost price of the assets. Most assets are not, however, permanent; they become of less value each year and eventually need to be replaced. Such decrease in value, which is termed "depreciation," may arise through one or more of several causes, according to the nature of the asset concerned and the use to which it is put.

Depreciation may be defined as the decrease in value of an asset through any cause; as it represents a loss or expense of carrying on business, it must be recorded in the books of account in order that the true profit or loss on trading may be ascertained and that the true present value of the assets may be shown in the Balance Sheet.

Depreciation arises chiefly through :—

(a) WEAR AND TEAR. The decrease in value through use, as in the case of machinery.

(b) EFFLUXION OF TIME. The automatic reduction in value resulting from the passage of time, e.g., a lease for ten years costing £1,000 becomes valueless at the expiration of its term, and depreciation from this cause takes place to the extent of £100 per annum.

(c) OBSOLESCENCE. This is a source of depreciation which arises if an asset is rendered obsolete through its being superseded by a similar one of a new and improved type; e.g.. it may be necessary to scrap a machine which is practically new, owing to the introduction of an improved type, which does the same amount of work at half the running cost of the old pattern.

Theoretically, as depreciation is continuous, it should be recorded from day to day, or even from hour to hour, but as this is impossible, it is the custom to write off the loss resulting from wear and tear or effluxion of time at the end of each trading period. As the loss which may arise through obsolescence can neither be ascertained in advance nor estimated, it is usual to ignore it in providing for depreciation, and to write off any loss under this heading as soon as possible after an asset is superseded by an improved one (see page 99). Alternatively, an attempt may be made to take obsolescence into account by writ-

ing off depreciation over a smaller number of years than would be necessary if there were no possibility of obsolescence. This alternative method whereby obsolescence is taken into account is frequently encountered nowadays in cases where it is reasonably certain that the asset will become obsolete in a number of years (e.g., motor vehicles and electrical equipment).

Several methods of calculating the annual charge for depreciation are adopted in practice. Of these, the two simplest and most generally used will now be considered. They are known as the "Fixed Instalment System" and the "Reducing Instalment System" respectively.

Fixed Instalment System of Depreciation.

This method involves a knowledge of :—

(1) The present "book" value of the asset ;

(2) The estimated date when the asset will cease either to exist or to give useful service ; and

(3) The estimated residual or scrap value (if any) of the asset.

From this information the annual charge for depreciation is ascertained by dividing the present book value, less the residual value, by the life of the asset, expressed in years. An equal amount is then written off each year by crediting the account of each asset involved, and debiting the Profit and Loss Account so that the book value of the asset is reduced to the scrap value or entirely eliminated, as the case may be, by the end of the period estimated to be the "life" of the asset.

This method is very simple and convenient when the asset comprises a single unit, such as a lease, but it does not work satisfactorily when applied to an asset which is frequently changed by the disposal of worn-out units and the acquisition of new ones, e.g., Plant and Machinery, because in such a case each entry in the asset account involves a separate calculation for depreciation.

EXAMPLE.

On 1st January, 1938, *X* purchased a motor van for £800. He estimates that at the end of five years it will be worth only about £70 as scrap, and decides to provide for depreciation by the Fixed Instalment System.

Set out the journal entry, writing off the first year's depreciation, and show the Motor Van Account, written up to 31st December, 1942, assuming that *X* closes his books on 31st December each year.

JOURNAL.

		£ s. d.	£ s. d.
1938			
Dec. 31	Profit and Loss Account . *Dr.*	146 0 0	
	To Motor Van Account . .		146 0 0
	Being depreciation for the year 1938 written off.		

NOTE : The annual amount of depreciation is arrived at thus :—

Book value	£800
Less Residual Value	70
	£730
One-fifth thereof	£146

Dr. MOTOR VAN ACCOUNT. *Cr.*

1938		£	1938		£
Jan. 1	To Cash . .	800	Dec. 31	By Profit and Loss Account	146
			„ 31	„ Balance *c/d.* . .	654
		£800			£800
1939			1939		
Jan. 1	To Balance *b/d.* .	654	Dec. 31	By Profit and Loss Account	146
			„ 31	„ Balance *c/d.* . .	508
		£654			£654
1940			1940		
Jan. 1	To Balance *b/d.* .	508	Dec. 31	By Profit and Loss Account	146
			„ 31	„ Balance *c/d.* . .	362
		£508			£508
1941			1941		
Jan. 1	To Balance *b/d.* .	362	Dec. 31	By Profit and Loss Account	146
			„ 31	„ Balance *c/d.* . .	216
		£362			£362
1942			1942		
Jan. 1	To Balance *b/d.* .	216	Dec. 31	By Profit and Loss Account	146
			„ 31	„ Balance *c/d.* . .	70
		£216			£216
1943					
Jan. 1	To Balance *b/d.* .	70			

NOTE: The annual charge of £146 may alternatively be debited to Profit and Loss Account *via* Depreciation Account. See page 98.

Plant Registers.

It has been stated that one of the drawbacks of the Fixed Instalment System is that where additions and/or disposals of units of the asset are numerous, complications arise in computing the annual depreciation charge. This drawback may be largely overcome by the use of a Plant Register, which takes the form of a record relating to each item of plant purchased and used by the business. A ruling for such a register would depend upon the nature of the plant and the statistical information which it is required to preserve, but that on the opposite page would serve as a general ruling.

The register, which may be kept in loose-leaf or card form, has the following advantages :—

(1) It preserves a financial and statistical record relating to individual items of plant, showing, in particular :—

(*a*) Original cost and date of acquisition ;

(*b*) Dates and cost of subsequent additions or improvements ;

(*c*) Basis upon which depreciation is charged and amount written off each year ;

(*d*) Balance remaining on the asset account at any given time, i.e., original cost plus additions less depreciation written off.

(2) It prevents depreciation from being charged in respect of any individual item of plant after its entire cost has been written off. On the other hand, it ensures that any losses incurred on the sale of assets before the end of their anticipated working life are not lost sight of.

PLANT REGISTER.

Type of Machine..............Date of Purchase..........Estimated Life.............
Ref. No..........................Makers.......................Estimated Scrap Value...
Situation.........................Suppliers...................Depreciation Rate.........
Income Tax, Wear and Tear Allce..............

Remarks ....

Date.	Particulars.	Amount.	Depn.	Bal. fwd.	Repairs,etc.	Notes.

(3) The adequacy of the amounts provided for depreciation in the past can be checked and a more accurate basis adopted for new items. In particular a rate may be fixed for each item of plant and the total provision for depreciation can thus be calculated with greater accuracy.

(4) The book value of plant shown in the Balance Sheet can be substantiated by a detailed schedule of individual machines, etc.

(5) If the expenditure on repairs to each item of plant is recorded, the ratio thereof to the capital value may be computed, thus affording valuable data as to the relative efficiencies of different machines, etc.

(6) In the case of movable plant (e.g., contractors' plant) a valuable check is afforded on its continued existence in the possession of the owners.

Reducing Instalment System of Depreciation.

In this system, as in the Fixed Instalment System, it is necessary to know the cost of the asset or its present value as shown in the books, and to estimate the residual value and the life of the asset to be depreciated.

A fixed percentage is then written off the *diminishing value* of the asset each year, so that, at the end of the life of the asset, its value as shown in the books coincides approximately with the estimated scrap value. This method is generally used for such assets as Plant and Machinery, Fixtures and Fittings, etc., as the calculation of the charge for depreciation is not complicated by sales of a portion of the assets or by additions thereto.

The annual charge, which is credited to the asset account and debited to Profit and Loss Account, is at a constant rate per cent., but its actual amount naturally diminishes as the book value of the asset is reduced by successive credit entries for depreciation.

At first sight this method appears to burden the Profit and Loss Account with an unfairly heavy charge for depreciation during the early years of the life of the asset, but having regard to the fact that the expenditure on repairs and renewals (which is quite distinct from depreciation) is negligible when the asset is new, and tends to increase as the asset becomes older, the net result is not inequitable, the increasing cost of repairs, etc., being off-set *to some extent* by the decreasing charge for depreciation.

EXAMPLE.

On 1st January, 1938, *X* purchases three machines for £900, and adds two other machines, costing £300 each, on 1st June, 1939 and 1st February, 1940, respectively. He decides to provide for depreciation under the Reducing Instalment System by writing off 20 per cent. of the diminishing value each year. Show the journal entries writing off depreciation for the first two years and write up *X's* Machinery Account for the five years ending 31st December, 1942.

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		£ s. d.	£ s. d.
1938 Dec. 31	Profit and Loss Account . *Dr.*	180 0 0	
	To Machinery Account . .		180 0 0
	Being depreciation for the year 1938 written off (20% of £900).		
1939 Dec. 31	Profit and Loss Account . *Dr.*	144 0 0	
	To Machinery Account . .		144 0 0
	Being depreciation for the year 1939 written off (20% of £900 – £180) . .		

Dr. MACHINERY ACCOUNT. Cr.

			£ s. d.				£ s. d.
1938 Jan. 1	To Cash		900 0 0	1938 Dec. 31	By Profit and Loss Account .		180 0 0
				" 31	" Balance . .	c/d.	720 0 0
			£900 0 0				£900 0 0
1939 Jan. 1	To Balance .	b/d.	720 0 0	1939 Dec. 31	By Profit and Loss Account .		144 0 0
June 1	" Cash .		300 0 0	" 31	" Balance . .	c/d.	876 0 0
			£1,020 0 0				£1,020 0 0
1940 Jan. 1	To Balance . .	b/d.	876 0 0	1940 Dec. 31	By Profit and Loss Account .		175 4 0
Feb. 1	" Cash . .		300 0 0	" 31	" Balance . .	c/d.	1,000 16 0
			£1,176 0 0				£1,176 0 0
1941 Jan. 1	To Balance . .	b/d.	1,000 16 0	1941 Dec. 31	By Profit and Loss Account .		200 3 2
				" 31	" Balance . .	c/d.	800 12 10
			£1,000 16 0				£1,000 16 0
1942 Jan. 1	To Balance . .	b/d.	800 12 10	1942 Dec. 31	By Profit and Loss Account .		160 2 7
				" 31	" Balance . .	c/d.	640 10 3
			£800 12 10				£800 12 10
1943 Jan. 1	To Balance . .	b/d.	640 10 3				

It should be noted that opinions differ as to the correct method of treating additions *in the first year* of their existence. The following methods have been advocated. They do not introduce any real difficulty.

(1) The additions are ignored by the calculation of depreciation on the *opening* balance of the account, e.g., in the case of the above example depreciation on the machine purchased on 1st June, 1939, is ignored until 1940. This is the method usually employed and has been used in the above example.

(2) The additions are included in the calculation of depreciation by basing the calculation on the *closing* balance, e.g., in the case of the above example depreciation at the full rate of 20 per cent. is included in 1939 in respect of the machine purchased on 1st June, 1939. This is the most conservative method and is advocated by some authorities for this reason.

(3) The additions are depreciated proportionately, by applying to them that fraction of the normal rate which is equal to that fraction of the year during

which they have been in possession. This method is frequently applied in practice where there are important additions, e.g., if, in the above example, it was decided to provide for the depreciation in 1939 of the machine purchased on 1st June, the £144 written off would be increased by £35, being seven months' depreciation on £300 at 20 per cent. per annum.

It is held by some accountants that the ledger entries described on page 93, i.e., debiting Profit and Loss Account and crediting the Asset Account with the amount of depreciation, give too little information. Thus, an entry " By Profit and Loss Account " in the Plant Account may represent depreciation, loss on sale, or obsolescence. The system recommended involves the use of an account headed " Depreciation," to which all entries for pure depreciation are debited, the corresponding credit entry being " By Depreciation Account " in the account of the asset involved. The total of the debits in the Depreciation Account will be carried to the Profit and Loss Account in the usual way at the end of the period. This method obviously involves extra labour, and is therefore not recommended for use in an examination, but it is one that is often found in practice.

It is important to observe that whereas under the Fixed Instalment system, a fixed depreciation percentage charged each year upon the original cost will eliminate the asset during its life, the same percentage, if calculated on the diminishing book value, will leave a substantial balance on the account at the end of the life of the asset.

Unless a residual value is decided upon, the calculation of a depreciation rate by the Reducing Instalment System is impossible ; for no rate less than 100 per cent. can reduce any balance to zero, however small that balance may be, and a rate of 100 per cent. would charge the whole of the cost of the asset to revenue in the first year.

Depreciation distinguished from Fluctuation.

Other methods of providing for depreciation are dealt with in Chapter VII, but it should be noted here that the term " depreciation " is not synonymous with " fluctuation in value." A trader may purchase some machinery the useful life of which is estimated at twenty years, and he may arrange the depreciation charge on that basis. Twelve months later, the current market price of similar machinery, owing perhaps to over-production, or possibly to improvements in methods of manufacture, may fall, possibly by 40 per cent. From the trader's point of view, there is no necessity—while his business is a going concern—to take into account the reduction in the *market value* of the asset, provided that he has arranged to write off the cost (less scrap value) during

its working existence. In circumstances such as these, there is no reduction in the revenue-earning capacity of the machinery, and the trader would, in fact, incur actual loss only if he was compelled for some reason to sell the machinery concerned.

Obsolescence of Plant and Machinery.

As a result of the adoption of new methods and of the invention of new processes and machinery, manufacturers sometimes find that their plant and machinery has become out of date, and that unless the new and more efficient type of machinery is installed they will probably suffer loss of trade, or at any rate, loss of profits. In such circumstances it becomes necessary to scrap existing plant, although it may still be good for several years' service, and to instal new plant. The loss revealed on the existing plant account may be too severe to be properly chargeable against the profits of one year only. Accordingly, after crediting to the Plant Account the amount realised on the sale of the obsolete plant, the resulting deficiency may be transferred to an "Obsolete Plant Suspense Account," which is written down gradually by the debit of a proportionate part to Profit and Loss Account, and the loss is thus spread over a limited number of years—the fewer the better.

It is sometimes held that, theoretically, the balance of the "Obsolete Plant Suspense Account" should be written off over a period equal to the average estimated useful life remaining to the plant scrapped; the reason given being that the improved plant would normally have been purchased when the old plant was worn out; as it has been purchased earlier, the intervening years have received an "Advance benefit," and the cost should be written off against the profits of those years. As a matter of accountancy theory this treatment has its good points, but in business it is advisable to write off losses as rapidly as possible, and this course should always be adopted in actual practice.

Nominal Accounts and their Adjustment.

Nominal accounts are those which record the trader's expenses and losses, his income and his gains. At the end of each trading period (yearly, half-yearly, etc., as the case may be) the debit balances of these accounts are transferred to the debit of the Profit and Loss Account, and the credit balances are similarly transferred to the credit of this account.

In order that the true trading result may be disclosed, it is, of course, essential that the whole of the expenditure incurred (whether actually paid or not) and that the whole of the losses sustained (whether actually ascertained or only estimated) during the period covered by the Profit and Loss Account should be charged against the profits for that period. In a similar

manner, the income or gains (whether actually received or not) in respect of the period under review should be credited to the Profit and Loss Account against the expenditure properly chargeable to such period.

In practice, however, it is almost invariably found that at the closing date of the trading period some expense or outlay relating to that period has been incurred, but that it has not been charged in the accounts; or, conversely, that expenditure recorded in the accounts covers a period which extends beyond the closing date of the trading period. Similarly, it is found that income applicable to the current period has not yet been received, or that income received during the current period relates wholly or partly to the succeeding period. Accordingly, adjusting entries must be made in order to ascertain the true total income and expenditure for the period to which the accounts relate.

EXAMPLE.

X started business on 1st January, 1941. The rent of his business premises is £500 per annum, payable at the end of March, June, September, and December. The rates on the premises, which are payable in advance, amount to £100 for the period from 1st January to 31st March, 1941; £200 each for the half years to 30th September, 1941 and 31st March, 1942. Assuming that the following payments were made for rent and rates, write up the nominal accounts involved, and close the accounts as at 31st December, 1941.

PAYMENTS FOR RENT.

1941.		
April 1.	3 mos. to 31st March 1941	£125
July 4	„ „ 30th June, 1941	125
Oct. 5.	„ „ 30th Sept., 1941	125
1942.		
Jan. 2.	„ „ 31st Dec., 1941	125

PAYMENTS FOR RATES.

1941.		
Jan. 4.	3 mos. to 31st March. 1941	£100
April 13.	6 „ „ 30th Sept., 1941	200
Oct. 4.	6 „ „ 31st March, 1942	200

In the above example, it will be seen that, while the rent of *X*'s premises is £500 per annum, he has actually paid during the year 1941 only £375.

In order to obtain accuracy in the Profit and Loss Account and Balance Sheet, it is necessary to record that :—

(*a*) The expense of a further quarter's rent has been incurred;

(*b*) At 31st December, 1941, *X* had a liability of £125 in respect of (*a*).

The adjustment necessitated by these two items may be effected in the books by passing a journal entry as follows :—

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		£	£
1941 Dec. 31	Rent Account (1941) . . . . *Dr.*	125	
	To Rent Account (1942)		125
	Being one quarter's rent accrued but unpaid at this date.		

The Rent Account, after effect has been given to the above adjustment, will appear as under :—

Dr. RENT ACCOUNT. *Cr.*

1941			£	1941			£
April 1	To Cash . .		125	Dec. 31	By Profit and Loss Account . .		500
July 4	" " . .		125				
Oct. 5	" " . .		125				
Dec. 31	" Reserve . .	*c/d.*	125				
			£500				£500
1942				1942			
Jan. 2	To Cash . .		125	Jan. 1	By Reserve .	*b/d*	125

NOTE.—The balance of £125 brought down is shown in the Balance Sheet as a liability and the Profit and Loss Account is charged with a full year's rent, notwithstanding the fact that only three-quarters thereof has actually been paid during the year under review.

In the case of the amount paid in respect of rates, the position is reversed, for a sum representing the rates for the first three months of 1942 has been paid in advance. It is therefore necessary, on closing the books at 31st December, 1941, to reduce the charge to Profit and Loss Account and to show the amount paid in advance as an asset. This is done by means of entries similar to those shown on page 100, Rates Account being credited in the old period and debited in the new period with £100.

JOURNAL.

1941			£	£
Dec. 31	Rates Account (1942) . . . *Dr.*		100	
	To Rates Account (1941) . . .			100
	Being three months' rates paid in advance.			

The Rates Account appears as follows, with the £100 brought down as a debit balance at the commencement of the next period, thus :—

Dr. RATES ACCOUNT. *Cr.*

1941			£	1941			£
Jan. 4	To Cash . .		100	Dec. 31	By Reserve . .	*c/d.*	100
Apr. 13	" " . .		200	" 31	" Profit and Loss Account . .		400
Oct. 4	" " . .		200				
			£500				£500
1942							
Jan. 1	To Reserve . .	*b/d.*	100				

The adjustments for rent and rates will appear in the Balance Sheet as follows :—

BALANCE SHEET

As at 31st December 1941

Liabilities.	£	*Assets.*	£
Sundry Creditors:		Sundry Debtors:	
Rent Outstanding .	125	Rates paid in advance .	100

Similar reserves to the above are frequently necessary in respect of such items as :—

(1) Wages ; e.g., reserving a portion of a week's wages from the last pay day until the date of the Balance Sheet when the latter is dated in the middle of a week.

(2) Commission due to travellers, etc. The amount must be calculated, and reserved by debiting Commission Account and bringing down the item as a credit balance, which is shown in the Balance Sheet as a liability.

(3) Insurance Premiums. These are payable in advance, and it is often necessary to credit the nominal account with a sum representing the unexpired portion of the premiums paid, and to bring the item down as a debit balance, which appears in the Balance Sheet as an asset.

(4) Advertising Charges. A trader frequently purchases space, or arranges for an " advertising campaign," running into two or possibly more trading periods. Even if the expense incurred is not paid in advance, an entry will be made increasing the trader's sundry creditors, so that an apportionment on the lines indicated in the example above (" Rates Account ") becomes necessary if each period's trading is to bear its appropriate share of expenses.

(5) Interest and Dividends on Investments. It is frequently found that interest and dividends have accrued due on fixed-interest bearing investments at the end of the current period but have not yet been received. In such cases an adjustment is necessary (provided there is no doubt that the interest or dividends will be received in due course) in order that the Profit and Loss Account may show the true income for the period. The interest and dividends accrued due but not yet received must be calculated, and reserved for by crediting Interest and Dividends

Account and bringing down the item as a debit balance, which appears as an asset (Income Due but not Received) in the Balance Sheet.

(6) RENTS RECEIVABLE. If a trader sub-lets a portion of his premises and the rents therefor are received in advance, it is often necessary to debit Rents Receivable Account with a sum representing the unexpired portion of the rents received during the current period, and to bring the item down as a credit balance, which appears as a liability (Income Received in Advance) in the Balance Sheet.

These adjusting entries may be made direct in the ledger accounts, but for examination purposes it is advisable to make a corresponding explanatory journal entry.

Alternative Method of Dealing with Apportionments in Nominal Accounts.

While the foregoing method of dealing with adjustments in the nominal accounts is recommended to the student, and is the one usually adopted in practice, some authorities advocate the transfer of outstanding items of the type referred to above, to specially opened Suspense Accounts, which in the cases considered would be headed "Reserve for Outstanding Rent Account" and "Rates Paid in Advance Account" respectively. If this method is used the journal entries will appear as follows :—

JOURNAL.

1941			£	£
Dec. 31	Rent Account . . . . . *Dr.*		125	
	To Reserve for Outstanding Rent Account			125
	Being one quarter's rent accrued but unpaid.			
,, 31	Rates Paid in Advance Account . *Dr.*		100	
	To Rates Account			100
	Being three months' rates paid in advance.			

The entries in the Profit and Loss Account are exactly the same as in the previous method, but at the date of the Balance Sheet the outstanding items appear on accounts which define exactly what the balances represent, instead of being brought down as balances on the nominal accounts. At the commencement of the ensuing financial period, to which the adjusted items are correctly applicable, the suspense accounts will be closed through the journal by the transfer of their balances to the relative

nominal accounts; i.e., in the above example, the Outstanding Rent Account will be debited and Rent Account will be credited with £125. whilst Rates Account will be debited and Rates Paid in Advance Account credited with £100. In due course the outstanding rent will be paid, and the Rent Account will be debited with £125 through the Cash Book, whereas the £100 to the debit of Rates Account will be included in the total of that account which is debited to the Profit and Loss Account for the ensuing period.

Reserves for Discount and Bad Debts.

In a similar manner, reserves are customarily made for cash discounts which will become allowable to debtors as amounts due from them are paid, and also for possible bad debts; the underlying principle being to show in the Balance Sheet, as nearly as possible, the net amount that will eventually be received from sundry debtors. Reserves for discounts which will be allowed by sundry creditors when amounts owing to them are paid are also made in the same way in order to show the net amount that will eventually be paid to creditors.

It is not possible to provide for the exact amount which will be allowed to debtors in respect of cash discount, as this depends upon payment being made within the prescribed time. (See *ante*, page 36.) It is, however, possible to fix an average percentage of the total, which, in view of past experience, is likely to approximate to the discounts actually deducted, and this method is adopted in practice, the rate varying from $1\frac{1}{4}$ per cent. to 5 per cent. according to the ruling rate for cash discounts in the case of the particular trade concerned.

As previously stated, all debts known to be bad must be written off forthwith to the Bad Debts Account. In order to ensure that the debtors are not overstated in the Balance Sheet, a responsible official, assisted by the clerk in charge of the ledger concerned, should carefully review the whole of the debtors' balances as at the date of the Balance Sheet, and write off any amounts the recovery of which seems improbable, having regard to the length of time for which they have been outstanding, and any knowledge he may possess as to the financial position of the debtors involved.

In addition to writing off actual bad debts and those which are anticipated to be irrecoverable, it is prudent to provide for possible future loss through bad debts by reserving a percentage of the total debtors.

There are two methods of recording this in the books :—

(1) The amount to be reserved is debited direct to Profit and Loss Acccount, and credited to a Bad Debts

Reserve Account, the balance on the Bad Debts Account being debited to Profit and Loss Account; *or*

(2) The reserve is debited to the Bad Debts Account and either credited to a Bad Debts Reserve Account as before, or carried down as a credit balance on the Bad Debts Account itself.

Both the above methods are encountered in practice. The entries relating to the creation and adjustment of reserves for bad and doubtful debts and discounts should be recorded in the Journal for memorandum purposes, a detailed narration accompanying each entry.

Debtors who fail to pay their accounts obviously cannot be allowed any cash discount, so when percentage reserves are made to provide for bad and doubtful debts and discounts respectively, the latter should be calculated upon the net total of debtors *after* deducting the amount reserved to provide for doubtful debts.

EXAMPLE.

At 31st December, *X's* Discounts Allowed Account and Discounts Received Account showed discounts allowed to debtors and discounts received from creditors amounting to £548 and £196 respectively. The total amount owing by Sundry Debtors at that date, after writing off bad debts, was £12,500, whilst £8,400 was owing to Sundry Creditors. It is desired to make a reserve for bad and doubtful debts of 5 per cent. on the total debtors, and reserves of $2\frac{1}{2}$ per cent. for cash discounts on debtors and creditors. The bad debts written off during the year amounted to £342. Write up the Bad Debts and Discounts Accounts, and show how the items "Sundry Debtors" and "Sundry Creditors" would appear in the Balance Sheet on 31st December.

METHOD I.

Dr. BAD DEBTS ACCOUNT. *Cr.*

		£ s. d.			£ s. d.
19..			19..		
—	To Sundries . .	342 0 0	Dec. 31	By Profit and Loss Account . .	342 0 0
		£342 0 0			£342 0 0

Dr. BAD DEBTS RESERVE ACCOUNT. *Cr.*

					£ s. d.
			19..		
			Dec. 31	By Profit and Loss Account (5% on £12,500) . .	625 0 0

Dr. DISCOUNTS ALLOWED ACCOUNT. *Cr.*

		£ s. d.			£ s. d.
19..			19..		
—	To Sundries . .	548 0 0	Dec. 31	By Profit and Loss Account . .	548 0 0
		£548 0 0			£548 0 0

Dr. DISCOUNTS RECEIVED ACCOUNT *Cr.*

			£ s. d.				£ s. d.
19.. Dec. 31	To Profit and Loss Account . .		196 0 0	19.. —	By Sundries . .		196 0 0
			£196 0 0				£196 0 0

Dr. RESERVE FOR DISCOUNTS ON CREDITORS. *Cr.*

			£ s. d.				
19.. Dec. 31	To Profit and Loss Account ($2\frac{1}{2}$% on £8,400) . .		210 0 0				

Dr. RESERVE FOR DISCOUNTS ON DEBTORS. *Cr.*

							£ s. d.
				19.. Dec. 31	By Profit and Loss Account ($2\frac{1}{2}$% on £12,500—£625) .		296 17 6

The items will appear in the Balance Sheet as shown on page 107.

METHOD B.

Dr. BAD DEBTS ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19.. —	To Sundries . .		342 0 0	19.. Dec. 31	By Profit and Loss Account . .		967 0 0
Dec. 31	„ Reserve for Bad and Doubtful Debts (5% on £12,500) . .	c/d.	625 0 0				
			£967 0 0				£967 0 0
				19.. Jan. 1	By Reserve . .	b/d	625 0 0

Dr. DISCOUNTS ALLOWED ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19.. —	To Sundries . .		548 0 0	19.. Dec. 31	By Profit and Loss Account . .		844 17 6
Dec. 31	„ Reserve for Discounts on Debtors ($2\frac{1}{2}$% on £12,500 —£625) . .	c/d.	296 17 6				
			£844 17 6				£844 17 6
				19.. Jan. 1	By Reserve . .	b/d.	296 17 6

Dr. DISCOUNTS RECEIVED ACCOUNT. Cr.

			£ s. d.				£ s. d.
19.. Dec. 31	To Profit and Loss Account . .		406 0 0	19.. —	By Sundries . .		196 0 0
				Dec. 31	,, Reserve for Discounts on Creditors ($2\frac{1}{2}$% on £8,400) . .	c/d	210 0 0
			£406 0 0				£406 0 0
19.. Jan. 1	To Reserve . .	b/d.	210 0 0				

BALANCE SHEET.
As at 31st December, 19 .

Liabilities.	£ s. d.	£ s. d.	*Assets.*	£ s. d.	£ s. d
Sundry Creditors	8,400 0 0		Sundry Debtors . .	12,500 0 0	
less Reserve for Discounts .	210 0 0	8,190 0 0	*less* Reserve for Bad Debts £625 0s. 0d.; Discounts £296 17s. 6d.	921 17 6	11,578 2 6

Where there is already a Bad Debts Reserve in existence (this will normally be the case in all years subsequent to that in which the Bad Debts Reserve was first created) only the difference between the old reserve and the new reserve is charged to Profit and Loss Account. The example given below will make this clear :—

Dr. BAD DEBTS RESERVE ACCOUNT. Cr.

			£ s. d.				£ s. d.
1940 Dec. 31	To Balance (5% on Debtors, £14,000)	c/d.	700 0 0	1940 Jan. 1	By Balance (5% on Debtors, £10,000)	b/d.	500 0 0
				Dec. 31	,, Profit and Loss Account . .		200 0 0
			£700 0 0				£700 0 0
				1941 Jan. 1	By Balance . .	b/d.	700 0 0

If the closing reserve is less than the opening reserve (this will be the case where the closing debtors are less than the opening debtors) the Profit and Loss Account should be *credited* with the amount of the reduction.

Similar considerations apply to discounts reserves when there is already a reserve in existence It should be noted, however, that these remarks apply only where the method set out on page 105 is adopted, as in the case of the alternative method set out on page 106 the actual amount of bad debts and discounts during the financial year affect the amounts transferred to Profit and Loss Account.

Closing the Books.

At the end of the trading period, the ledgers are closed (i.e., the ledger accounts are ruled off and the balances brought down), for the purpose of balancing the books, and compiling the Trading and Profit and Loss Accounts and Balance Sheet, to enable the trader to ascertain his position and the results of his operations for the preceding trading period.

The first step is to prove the arithmetical accuracy of the entries in the ledger by means of a Trial Balance. It will be obvious to the reader that the final totals of the Trial Balance will not agree where :—

(1) A debit entry is made and the equalising credit omitted ; *or*
(2) Two debit entries are made instead of one debit and one credit, or vice versa ; *or*
(3) An incorrect amount is entered in one ledger account, the corresponding debit or credit being correct.

Therefore, in so far as the detection of errors of these three types is concerned, the extraction of a Trial Balance, the totals of which are in agreement, is satisfactory evidence that the whole of the transactions have been correctly posted to the debit and credit sides of the ledger.

Errors which a Trial Balance does not Disclose.

It is important, however, to recognise clearly that a Trial Balance which is in agreement is not proof of the absolute accuracy of the books. There are five classes of errors which are not disclosed, viz. :—

(1) Errors of omission ;
(2) Errors in original entry ;
(3) Errors of commission ;
(4) Errors of principle ; and
(5) Compensating errors.

Errors of Omission relate to transactions the entries for which are entirely omitted from the books.

Errors in Original Entry which do not affect the Trial Balance may arise when an entry is made incorrectly in a book of prime entry and the incorrect amount is posted to the ledger.

Errors of Commission consist of entries of transactions in a wrong account of the same class ; e.g., debiting (or crediting) A. Smith's account instead of the account of Smith Brothers.

Errors of Principle relate to entries of transactions in the wrong class of account ; e.g., debiting an asset account instead of an expense account, or vice versa.

Compensating Errors are those which counteract each other and thus do not affect the agreement of the trial balance, e.g., an overposting of £10 on the debit side of the Debtors Ledger may be compensated by an overcast of £10 in the additions of the Sales Day Book. Such a state of affairs should rarely, if ever, arise where there is a satisfactory internal check in operation (i.e., where the entries in the books are systematically and carefully checked and examined), and the agreement of the Trial Balance is usually accepted as proof, subject to audit, of the accuracy of the books.

The Correction of Errors.

Errors which do not affect the Trial Balance may come to light in a number of ways. Thus, a complaint from a customer may reveal the fact that he has been charged in error with goods supplied to some other customer; an error of principle or a compensating error will very probably be discovered when the books are being audited ; and so on.

As already explained in Chapter II, the entries necessary to correct these errors should be passed through the principal Journal, accompanied by adequate narrations. This is preferable to merely ruling out the incorrect posting and inserting the correct one. Thus, when a sale of £10 is debited in error to W. Smith instead of to W. A. Smythe, the following correcting entry should be made in the principal Journal and posted therefrom to the respective ledger accounts :—

		£ s. d.	£ s. d.
W. A. Smythe	*Dr.*	10 0 0	
To W. Smith			10 0 0
Being correction of error in posting, ..., 19			

In the case of errors which affect the agreement of the Trial Balance, the practice is frequently adopted of making that statement " balance " by inserting therein an item " Suspense Account (Difference in Books)." Thus, if the debits in a Trial Balance exceed the credits by £30, the Trial Balance (in skeleton form) would appear thus :—

	Dr. £	*Cr.* £
Sundry Debit Balances	5,460	
Sundry Credit Balances		5,430
Suspense Account (Difference in Books)		30
	£5,460	£5,460

A Suspense Account will then be opened in the ledger and debited (or credited, as the case may be) with the amount of the difference; thus, in the above case it would be credited with £30. *There is no double entry made in the ledger in respect of this entry*, since it represents, in effect, the compensating entry for the error or errors made either in writing up the books or in extracting the Trial Balance. When each error is discovered, a corrective double entry is made, one entry being in the Suspense Account and the other in the account in which the error arose. [An exception to this arises in cases where the error was made *in extracting the Trial Balance*; in such cases the entries in the ledger are already correct and all that is necessary is a "one-sided" entry in the Suspense Account to adjust the incorrect entry in the Suspense Account.] When, therefore, each error which gave rise to the difference in the books has been discovered and rectified, the Suspense Account will be eliminated.

Where the Trading and Profit and Loss Accounts and Balance Sheet are prepared *before* the errors are discovered, the difference, which may be either a debit item or a credit item, is usually shown in the Balance Sheet as "Suspense Account (Difference in Books)." Some authorities, however, while agreeing that a credit balance should be shown on the liabilities side, advocate the writing off of any debit balance to Profit and Loss Account. It must be emphasised, however, that every attempt should be made to locate a difference in a Trial Balance, as the opening of a Suspense Account is merely a temporary expedient, pending location of the actual error or errors.

EXAMPLE.

On taking out a Trial Balance, it was discovered that there was a difference, which was carried to Suspense Account.

The following errors were subsequently located :—

(*a*) A purchase of goods from A. Brown for £120 had been credited to the account of W. Brown.

(*b*) A sale of goods to J. Jones (£27 5s. 6d.) had been posted to the credit of his account.

(*c*) Machinery sold for £190 had been credited to Sales Account.

(*d*) A sale of goods to T. Smith had been correctly recorded in the Sales Day Book as £120, but had been debited to his account as £12.

(*e*) The Sales Day Book was undercast by £200.

(*f*) An amount of £30, being Rent Payable accrued in the previous period, had not been brought forward as a balance on Rent Account.

(*g*) The Petty Cash balance of £12 11s. was omitted from the Trial Balance.

Give the Journal entries necessary to correct the books, and show the entries made in the Suspense Account.

JOURNAL.

		£	s.	d.	£	s.	d.
(a)	W. Brown . . . . . *Dr.*	120	0	0			
	To A. Brown				120	0	0
	Being correction of error in posting purchase to credit of W. Brown instead of A. Brown.						
(b)	J. Jones . . . . . *Dr.*	54	11	0			
	To Suspense Account . .				54	11	0
	Being entry necessary to correct posting of sale of £27 5s. 6d. to the wrong side of his account.						
(c)	Sales Account . . . *Dr.*	190	0	0			
	To Machinery Account . .				190	0	0
	Being correction of error in posting proceeds of sale of Machinery to Sales Account.						
(d)	T. Smith . . . . . *Dr.*	108	0	0			
	To Suspense Account . .				108	0	0
	Being correction of error in under-debiting sale by £108.						
(e)	Suspense Account . . . *Dr.*	200	0	0			
	To Sales Account				200	0	0
	Being adjustment of error in under-casting Sales Day Book by £200.						
(f)	Suspense Account . . . *Dr.*	30	0	0			
	To Rent Account				30	0	0
	Being adjustment of balance omitted.						

(g) No Journal entry is required to correct this error. The balance of £12 11s. is already correctly shown in the Petty Cash Book, the error having occurred *in extracting the Trial Balance.* A credit entry of £12 11s. to Suspense Account is therefore all that is necessary, although the usual practice is to make a *memorandum entry* (preferably in red ink) of the correction in the Journal, in order to preserve a record of the item.

Dr. SUSPENSE ACCOUNT. *Cr.*

19..		£	s.	d.	19..		£	s.	d.
	To Sales . .	200	0	0		By Difference in Books .	54	18	0
	,, Rent .	30	0	0		,, J. Jones .	54	11	0
						,, T. Smith .	108	0	0
						,, Petty Cash	12	11	0
		£230	0	0			£230	0	0

NOTES :—

(1) (a) and (c) do not affect the Suspense Account, since the entries, though made to the wrong accounts, are arithmetically correct.

(2) Since, in (*b*), Jones' account was credited, instead of debited, with £27 5s. 6d., the resulting difference is one of twice that amount, or £54 11s. The debit of £54 11s. made to Jones' account in the above solution is therefore, in effect, (i) a debit of £27 5s. 6d. to eliminate the incorrect credit, and (ii) a debit of £27 5s. 6d. to post the sale correctly.

(3) Rent Payable accrued in the previous period constitutes a credit balance. The failure to bring forward this figure therefore resulted in the debit balance on Rent Account being overstated by £30.

Errors which give rise to a difference in the books are sometimes of a rather complicated nature, and the necessary correcting entries may not be immediately apparent. It will be of assistance in such a case if the nature of the entry which must be made in the account affected by the error is first considered; it will then be obvious that, to complete the double entry, an entry must be made on the *opposite side* of the Suspense Account. Where the error arose in extracting the Trial Balance, it should first be considered whether the debit or the credit column of the Trial Balance is "short"; if, for instance, the omission of a balance due from a debtor makes the debit column "short," then a correcting entry must be made on the *credit* side of the Suspense Account, as a debit entry already appears in the Suspense Account to "make" the books balance, no other entry being necessary.

If, in the example on page 110, the Profit and Loss Account had been prepared *before* making the corrections it would have been affected as follows:—

(*a*) Would not affect the Profit and Loss Account, being merely an error in posting to two personal accounts.

(*b*) Would not affect the Profit and Loss Account, since only the personal account is affected.

(*c*) Would result in Sales being overstated by £190, and thus net profit would be too great (or net loss too small) by this amount.

(*d*) Would not affect the Profit and Loss Account, being similar to (*b*).

(*e*) Sales will have been understated by £200, resulting in net profit being understated (or net loss overstated) by this amount.

(*f*) Owing to the omission of a credit entry for £30 which would partially have offset the debits to Rent Account during the period, net profit will have been understated (or net loss overstated) by this amount.

(*g*) The omission of the Petty Cash Balance will not affect the Profit and Loss Account, as this would appear in the Balance Sheet only.

The net result is :

	Increased Profit or Decreased Loss.	Decreased Profit or Increased Loss.
	£	£
(a)	..	..
(b)	..	..
(c)	190	
(d)	..	..
(e)		200
(f)		30
(g)	..	..
	£190	230
		190
		£40

Net Profit would thus be understated (or Net Loss overstated) by £40, if the errors were not corrected.

The Trading Account.

After the Trial Balance has been agreed, any necessary adjustments must be made for outstanding items, payments in advance, etc., as outlined in the earlier pages of this chapter. The final accounts, i.e., the Trading Account and the Profit and Loss Account may then be prepared. The information from which these accounts are prepared, with the exception of the closing stock and adjustments, is contained in the Trial Balance ; the various balances of the nominal accounts are transferred, by means of journal entries, to the Trading Account and the Profit and Loss Account respectively, according to their nature.

If an item appears in the Trial Balance, it has already been passed through the books, and will appear once only, either in the Trading or Profit and Loss Accounts or in the Balance Sheet. On the other hand, if an item does *not* appear in the Trial Balance, but is shown in the list of adjustments or apportionments to be made, it has not been passed through the books, and will require to be shown *twice* in the final accounts and Balance Sheet in order to complete the double entry.

The Trading Account contains, on the debit side, the figures of—

(1) The commencing stock ;
(2) The total net purchases (returns outwards, if any, being deducted from the total gross amount of purchases) ;
(3) Productive wages and any other expenses incurred in production which vary directly with the turnover, e.g., Fuel and Carriage on goods purchased (carriage inwards).

On the credit side are entered—

(1) The total net sales for the period (returns inwards being deducted from the total gross amount of sales); and

(2) The amount of stock on hand at the end of the trading period.

Pro formâ TRADING ACCOUNT.

Dr.	FOR THE YEAR ENDED 31ST DECEMBER, 19...			*Cr.*
	£ s. d.	£ s. d.		£ s. d.	£ s. d.
To Stock at 1st January, 19..			By Sales . . *less* Returns Inwards .		
„ Purchases . *less* Returns Outwards					
„ Wages			„ Stock at 31st December, 19.. . . .		
„ Carriage Inwards . .					
„ Balance — Gross Profit transferred to Profit and Loss Account . .					
		£			£

As previously stated, the various items are transferred to the Trading Account from the nominal accounts by means of journal entries. The closing stock, however, does not appear in the ledger nor in the Trial Balance thereof, and therefore a journal entry must be made debiting the value of the closing stock, as ascertained by an actual stocktaking, to the Stock Account and crediting the Trading Account, thus :—

			£ s. d.	£ s. d.
19..				
Dec. 31	Stock Account . . . *Dr.*			
	To Trading Account . .			
	Being value of stock on hand at this date.			

The object of the Trading Account is to ascertain the result of the trader's transactions for the period under review, i.e., whether he has made a gross profit or gross loss on the goods which he buys and sells. Gross profit arises when the total amount of the sales plus the stock remaining on hand exceeds the cost of materials purchased, plus the stock brought in, wages and productive expenses. Gross loss, on the other hand, is the amount by which the total prime cost of production of the goods sold exceeds the total sale price realised, after adjusting any difference in respect of stock on hand and stock brought in at the commencement of the period,

The balance of the Trading Account is transferred to the Profit and Loss Account. Where a gross profit is realised, the appropriate journal entry is as follows :—

	£ s. d.	£ s. d.
Trading Account . . . *Dr.* To Profit and Loss Account . . *Being gross profit for the year.*		

Where, however, a gross loss results the entry will read :—

	£ s. d.	£ s. d.
Profit and Loss Account . . *Dr.* To Trading Account . . . *Being gross loss for the year.*		

The Profit and Loss Account.

Against the gross profit realised, the trader offsets the various expenses and losses incurred during the year's trading by transferring them to the debit of the Profit and Loss Account, while to the credit of this account he places any items of gain which have accrued to him during the period. The final balance remaining on the account determines whether he has made a net profit or sustained a net loss in respect of the whole of the year's operations.

Assuming that the gross profit plus any gains is greater than the various expenses and losses, i.e., that the credits exceed the debits, there will be a credit balance, which represents the "net profit." But where the expenses are greater than the gross profit plus gains, i.e., when the debits exceed the credits, there is a debit balance, which indicates a "net loss." In those cases where a gross loss is sustained, the various debits for expenses (less gains) are added to the gross loss in order to ascertain the net loss.

Pro forma PROFIT AND LOSS ACCOUNT.

FOR THE YEAR ENDED 31ST DECEMBER, 19...

Dr.	£ s. d.		£ s. d. *Cr.*
To Office Salaries . .		By Gross Profit transferred from Trading Account.	
,, Rent and Rates . .		,, Discounts Received .	
,, Insurance . . .		,, Rent of Premises Sub-let.	
,, Discounts Allowed . .			
,, General Office Expenses .			
,, Repairs			
,, Bad Debts . . .			
,, Bad Debts Reserve . .			
,, Depreciation— Fixtures and Fittings .			
,, Balance. — Net Profit transferred to Capital Account . . .			
£		£	

The balance of the Profit and Loss Account is transferred to the trader's Capital Account. If a net profit is realised the journal entry will read thus :—

	£ s. d.	£ s. d.
Profit and Loss Account . . *Dr.* To Capital Account . . . *Being net profit for the year transferred.*		

If a net loss is sustained, however, the entry will be :—

	£ s. d.	£ s. d.
Capital Account . . . *Dr.* To Profit and Loss Account . . *Being net loss for the year transferred.*		

The question of the destination of the various items of expense—whether they should be entered in the Trading Account or in the Profit and Loss Account—is one which sometimes causes difficulty. Definite rules cannot be laid down, for, in certain circumstances, items are properly chargeable to the Trading Account which would, in other circumstances, be charged to the Profit and Loss Account. Each case, therefore, must be considered on its merits. Broadly speaking, however, all charges which vary directly with the turnover and directly affect the prime cost of the articles sold should be charged to Trading Account, other items which do not vary in this manner being debited to Profit and Loss Account, e.g., productive wages, motive power, fuel, and carriage inwards should be debited to Trading Account, while salaries, carriage outwards, and office expenses should be debited to Profit and Loss Account. Although not usual, rent and rates are sometimes apportioned between factory and office, and where this information is given in an exercise, the factory portion should be debited to Trading Account.

Opinions differ as to whether depreciation of plant and machinery and repairs to plant and machinery should be debited to Trading Account or Profit and Loss Account. It is, however, considered that they are more correctly charged to Trading Account, for they are directly incurred in the production of goods which are to be sold.

In cases of doubt, or where it is not possible to apportion items between production and administration—e.g., where wages and salaries are shown in one total or where carriage is not designated as carriage inwards or outwards—the item should be debited to Profit and Loss Account and not to Trading Account. All expenses of selling, distribution, management and administration, should be charged to the Profit and Loss Account. To the credit of the latter will be placed such items of gain as interest received, commission received, discounts received, and others of a similar character.

Drawings of the proprietor, as distinct from salary, should not be charged against profits, but should be credited to cash and then debited, directly (or indirectly through a Drawings Account) to the proprietor's Capital Account.

The Balance Sheet.

After the balances of the various nominal accounts have been transferred to the Trading and Profit and Loss Accounts, and the balance of the Profit and Loss Account transferred to the Capital Account, the only accounts open in the ledger will consist of: Sundry Debtors' and Creditors' Accounts; Real or Property Accounts; Cash and Bank Accounts; Reserve Accounts; Capital Account; and Suspense and Adjustment Accounts.

From these accounts the Balance Sheet of the trader is compiled to show his position at the date of closing the books.

On the left-hand side of the Balance Sheet are entered the *liabilities* of the business and the trader's capital, as represented by the *credit* balances in the ledger; while on the right-hand side are entered the *assets*, which are represented by the *debit* balances in the ledger. The whole of the liabilities are thus "marshalled" and set off against the assets. If the assets exceed the liabilities, the difference should equal the amount of the trader's capital as shown in the ledger. When a trader is insolvent, his liabilities exceed his assets, and his Capital Account then shows a debit balance representing his deficiency. In such a case the deficiency appears on the assets side of the Balance Sheet, as it is the amount which is owed to the business by its proprietor.

The Function of the Balance Sheet.

It must be remembered that the Balance Sheet is not an "account," but is simply a classified statement which is intended to show, clearly and concisely, the financial position of the business at the date to which the accounts are made up. Hence the abbreviations "Dr." and "Cr." which appear as part of the heading of a ledger account are not properly applicable to the Balance Sheet, and, similarly, the words "To" and "By," as used in ledger accounts, should not be prefixed to the items in a Balance Sheet, as balances cannot be transferred to it.

It may be added, however, that some eminent accountants are of the opinion that the Balance Sheet is the equivalent of a ledger account as between the business and its proprietor or proprietors, and, accordingly, these authorities suggest that it should include both the abbreviations and the prefixes specified above.

The majority of authorities favour the former view that the Balance Sheet is *not* an account, and students may therefore safely omit these abbreviations and prefixes when preparing it.

The Classification of the Entries.

The principle of classification of accounts is extended to the Balance Sheet, and, indeed, it is essential that the various items composing it should be grouped and summarised concisely so that their exact meaning may be clearly understood and the principal features of the Balance Sheet grasped by those who examine it. There are two methods in practical use: when the first method is adopted the assets are arranged in the Balance Sheet in order of realisability, while by the second method they are arranged in the order of their permanence.

Each method has its advantages and its advocates, but the second arrangement, under which the assets are arranged in order of permanence, is increasingly favoured in modern commercial practice, except in the case of banking and investment concerns, when the first method is preferred.

The second method is followed in the present volume, and it is recommended that students also should adopt it. Arranging the assets in order of permanence they may be stated thus:—

1. Goodwill.
2. Freehold Land and Premises.
3. Leasehold Premises.
4. Plant and Machinery.
5. Fittings and Fixtures.
6. Stock.
7. Sundry Debtors:
   (a) On open accounts.
   (b) On bills receivable.
8. Cash at Bank:
   (a) On deposit account.
   (b) On current account.
9. Office Cash.
10. Fictitious Assets and Adjustments.

The assets would be marshalled in the reverse order when preparing the Balance Sheet of a bank or financial concern.

Obviously, goodwill is the most unrealisable form of asset, as it can be disposed of only in the event of the business being sold as a "going concern." Freehold premises are of a more permanent nature than leasehold premises, and the latter are more permanent than plant and machinery. Fittings and fixtures are less permanent than plant, but obviously take precedence over stock-in-trade. The latter has to be sold before it can become a "book debt," hence sundry debtors follow after stock-in-trade. Similarly, cash ranks after book debts, while fictitious assets and adjustments are shown last.

Included in fictitious assets are such items as Advertising Suspense Account and Obsolete Plant Suspense Account, where

it is desired to spread the cost of advertising or the loss through obsolescence over a few years. "Adjustments" have been considered earlier in this chapter, and the student will recollect that they are book entries made for the purpose of equalising expenses and income incurred over the periods to which they relate.

It should be added, however, that the method of arranging the assets in order of realisability has obvious advantages for certain classes of undertakings, such as banks and investment companies, in which concerns the liquid position is of paramount importance. But, nevertheless, the method of showing the assets in the order of permanence is more suitable for commercial undertakings generally, and, as previously stated, it is usually adopted by firms and companies of this class.

Similarly, there are two recognised methods of arranging the entries on the "Liabilities" side of the Balance Sheet. In the first method the liabilities are shown in the order in which they rank for payment, Capital being placed last of all. The second method shows the Capital first, followed by the liabilities in the order in which they rank for payment. The first method is usually adopted by sole traders and partnerships, while the second is almost invariably adopted by limited liability companies.

A Practical Illustration.

The method of compilation of the final accounts and balance sheet will now be illustrated by an example, showing the journal entries for the adjustments, the closing of the nominal accounts and the compilation of the final accounts. It should be carefully noted that while the Trading and Profit and Loss Accounts show the results of the trader's operations for a specified period, the Balance Sheet discloses the trader's financial position at a particular date. This difference is reflected in the headings of the two statements; thus a Trading Account covering a period of one year should be headed :—

TRADING ACCOUNT

Dr. *for the Year ended* 31st December, 19.. *Cr.*

while the title of a Balance Sheet appears as follows :—

BALANCE SHEET

as at 31st December, 19..

For convenience, the Trading Account and Profit and Loss Accounts are generally written on the same page of the Private Ledger or on the same sheet of paper, the balance of the former being carried down to the latter, and the whole headed :—

TRADING AND PROFIT AND LOSS ACCOUNTS

Dr. *for the Year ended* 31st December, 19.. *Cr.*

EXAMPLE.

From the following Trial Balance prepare Trading Account and Profit and Loss Account for the year ended 31st December, 19.., and Balance Sheet as at that date :—

TRIAL BALANCE AS AT 31ST DECEMBER 19...

	£	£
Stock at 1st January	4,600	
Purchases	15,020	
Returns Outwards		60
Cash in hand	340	
Bank	2,266	
Freehold Premises	1,860	
Incidental Trade Expenses	84	
Printing, Stationery and Advertising	164	
Professional Charges	28	
Reserve for Bad and Doubtful Debts		350
Sundry Debtors	3,600	
Sundry Creditors		2,967
Wages	2,900	
Salaries	1,000	
Capital (W. Hill)		10,000
Income Tax	160	
Discounts Allowed	630	
Discounts Received		460
Sales		19,895
Bills Receivable	320	
Office Furniture	305	
Rent, Rates and Insurance	400	
Returns Inwards	55	
	£33,732	£33,732

(a) Reserve for Bad and Doubtful Debts to be increased to £500.
(b) Reserve for Rent accrued due, £50.
(c) Write off 5% depreciation on Freehold Premises.
(d) Insurance to the amount of £20 relates to the year following that under review.
(e) Stock at 31st December, £5,200.
(f) Drawings amounting to £1,000 have been debited to Capital Account.

CLOSING JOURNAL ENTRIES.

Date	Particulars	Dr.	Cr.
		£	£
19.. Dec. 31	Trading Account . . . . . *Dr.*	22,575	
	To Sundries :—		
	Stock Account		4,600
	Purchases		15,020
	Returns Inwards		55
	Wages		2,900
	Being balances transferred.		
" "	Sundries . . . . *Dr.*		
	To Trading Account		19,955
	Sales	19,895	
	Returns Outwards	60	
	Being balances transferred.		
" "	Stock Account . . . . . *Dr.*	5,200	
	To Trading Account		5,200
	Being value of stock at close of the year.		
" "	Trading Account . . . . . *Dr.*	2,580	
	To Profit and Loss Account . .		2,580
	Being gross profit for year.		
" "	Profit and Loss Account . . . *Dr.*	2,496	
	To Sundries :—		
	Salaries		1,000
	Rent, Rates and Insurance . .		430
	Income Tax		160
	Printing, Stationery and Advertising		164
	Discounts Allowed		630
	Incidental Trade Expenses . .		84
	Professional Charges		28
	Being balances transferred.		
" "	Profit and Loss Account . . . *Dr.*	150	
	To Reserve for Bad and Doubtful Debts		150
	Being amount reserved . . . £500		
	less Reserve brought forward . 350		
	£150		
" "	Profit and Loss Account . . . *Dr.*	93	
	To Freehold Premises		93
	Being depreciation at 5% *on* £1,860.		
" "	Discounts Received Account . . *Dr.*	460	
	To Profit and Loss Account . .		460
	Being balance transferred.		
" "	Profit and Loss Account . . . *Dr.*	301	
	To Capital Account		301
	Being net profit for year transferred.		
		£53,810	£53,810

Dr. RESERVE FOR BAD AND DOUBTFUL DEBTS. *Cr.*

19..			£	19..			£
Dec. 31	To Balance . .	*c/d.*	500	Jan. 1	By Balance . .	*b/f.*	350
				Dec. 31	„ Profit and Loss Account .		150
			£500				£500
				19..			
				Jan. 1	By Balance . .	*b/d.*	500

Dr. RENT, RATES AND INSURANCE. *Cr.*

19..			£	19..			£
Dec. 31	To Sundries . .		400	Dec. 31	By Reserve for insurance paid in advance .	*c/d.*	20
„ „	„ Reserve for rent due . .	*c/d.*	50	„ „	„ Profit and Loss Account .		430
			£450				£450
19..				19..			
Jan. 1	To Reserve . .	*b/d.*	20	Jan. 1	By Reserve . .	*b/d.*	50

Dr. FREEHOLD PREMISES. *Cr.*

19..			£	19..			£
Jan. 1	To Balance . .	*b/f.*	1,860	Dec. 31	By Profit and Loss Account .		93
				„ „	„ Balance . .	*c/d.*	1,767
			£1,860				£1,860
19..							
Jan. 1	To Balance . .	*b/d.*	1,767				

NOTE.—The above ledger accounts are given to enable the reader to trace the adjustments through to the Profit and Loss Account and Balance Sheet. For examination purposes (unless specially asked for) they need not be given. Similarly, the closing Journal entries need not be given in an examination answer.

The following example illustrates, in a simple form, the Trading and Profit and Loss Accounts and Balance Sheet of a sole trader. In a later chapter, more comprehensive examples will be given, showing various types of adjustments and illustrating the division and disposal of the profits of partnerships and limited companies.

TRADING AND PROFIT AND LOSS ACCOUNTS.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19... *Cr.*

		£			£
To Stock on hand at 1st January, 19..		4,600	By Sales	£19,895	
	£		*Less* Returns Inwards	55	19,840
,, Purchases	15,020		,, Stock on hand at 31st December, 19..		5,200
Less Returns Outwards	60	14,960			
,, Wages		2,900			
,, Gross Profit		2,580			
		£25,040			£25,040
To Salaries		1,000	By Gross Profit		2,580
,, Rent, Rates and Insurance		430	,, Discounts Received		460
,, Income Tax		160			
,, Printing, Stationery and Advertising		164			
,, Discounts Allowed		630			
,, Incidental Trade Expenses		84			
,, Professional Charges		28			
,, Reserve for Bad Debts		150			
,, Depreciation of Premises		93			
,, Net Profit for year transferred to Capital Account		301			
		£3,040			£3,040

BALANCE SHEET.

AS AT 31ST DECEMBER, 19...

Liabilities.	£	£	*Assets.*	£	£
Sundry Creditors	2,967		Freehold Premises	1,860	
Rent accrued due	50	3,017	*Less* Depreciation @ 5°/。	93	1,767
W. Hill, Capital Account as at 1st Jan. 19..	11,000		Office Furniture		305
Less Drawings	1,000		Stock on hand		5,200
	10,000		Sundry Debtors	3,600	
Add Net Profit for year to date	301	10,301	*Less* Reserve for Bad and Doubtful Debts	500	3,100
			Bills Receivable		320
			Cash at Bank	2,266	
			Cash in hand	340	2,606
			Insurance paid in Advance		20
		£13,318			£13,318

EXERCISE 4.

A. In modern practice it is found desirable to subdivide the Goods Account into separate accounts for Stock, Purchases, Sales and Returns.

How are these accounts dealt with when it is necessary to ascertain the trading results? Illustrate your answer by *pro formâ* accounts, inserting imaginary figures.

B. A firm of Meat Importers, A. B. & Co., buy from the Arana Company, of South America, a shipment of chilled beef and frozen mutton, the invoice cost of which is £13,703 16s. 9d. The Arana Company, in forwarding the invoice, ask A. B. & Co. to collect on their behalf an amount of £904 10s. 6d. due by Braun & Co., London, to the Arana Company, and they enclose the necessary authority, and to buy on their account certain stores and machinery for shipment to South America. In pursuance of these instructions A. B. & Co. buy cotton cloths from Holroyd & Co., Manchester, to the amount of £1,064 3s. 6d., and machinery from the Rugby Refrigerating Co. costing £4,762 10s. Draw up the entries for A. B. & Co.'s Journal, recording these transactions, and post them to the appropriate Ledger accounts, and state the balance due to the Arana Company.

C. Differentiate between "depreciation," "obsolescence" and "fluctuation in value," in connection with the assets owned by a manufacturing business.

Illustrate your answer by giving examples which demonstrate the effect which the difference you describe has upon the accounts of the undertaking.

D. What various meanings may an entry in a ledger account have? Deal with both the debit side and the credit sides.

E. The following balances appear in the books of Martin Booker at 30th June:—

Machinery and Plant, £2,840; Office Furniture, £240; Motor Lorry, £1,400; Loose Tools, £520; Purchases, £9,684; Wages, £4,894; Bad Debts Reserve, £400.

Show the journal entries for the following adjustments and the completed ledger accounts:—

(*a*) The following depreciations are to be written off:—
Plant and Machinery 10%; Office Furniture 5%; Motor Lorry 20%; Loose Tools 15%.

(*b*) Sundry Loose Tools were made by the firm's workmen, and Wages £92, and Purchases £28, are to be transferred from these accounts to Loose Tools Account before calculating the above depreciation.

(*c*) The Reserve for bad debts is to be made up to £500.

F. George MacArthur is in business as a seedsman and nurseryman, and the following balances of ledger accounts are extracted from his books at 30th September:—

Freehold Nursery and Offices, £8,050; Greenhouses, £3,000; Tools and Implements, £390; Office Furniture, £160; Horses and Carts, £420; Motor Lorry, £1,500.

Shew the ledger accounts after making the following adjustments for depreciation:—

Freehold Nursery and Offices, 2%; Greenhouse, 15%; Tools and Implements, 20%; Office Furniture, 5%; Horses and Carts, 15%; Motor Lorry, 20%.

G. The Plant and Machinery Account of William Piper stood on 1st January, 1939, at £4,250, and the normal depreciation rate was 10% on the diminishing balance, excluding additions during the year. The additions during 1939 cost £500. During 1940 certain obsolete plant (proportionate book value £700), was replaced by more up-to-date plant costing £2,000. The scrapped plant was sold for £160, and it was decided to write off the loss over a period of three years. Show the Plant and Machinery Account, Depreciation Account and Obsolete Plant Suspense Account.

H. The books of P. Brown, Hardware Merchant, show the following balances on 31st December, 19..:—

	£
Plant and Machinery	20,000
Freehold Premises	9,000
Leasehold Premises	3,500
Stock on 1st January	41,000
Rent of Leasehold Premises	1,000
Repairs to Premises	1,500
Repairs to Machinery	2,500
Rates	1,900
Creditors	22,500
Debtors	27,255
Purchases	143,500
Reserve for Bad and Doubtful Debts	1,880
Office Furniture	920
Sales	175,261
Sundry Trade Expenses	3,525
Balance at Bank	6,725
Cash in Hand	2,466
Wages	27,500
Salaries	7,250
Bills Payable	10,900
Bills Receivable	1,000

From these figures ascertain P. Brown's capital, and prepare Trial Balance, Trading and Profit and Loss Accounts and Balance Sheet, writing off for depreciation 15% on Plant and Machinery, 10% on Office Furniture, 2% on Freehold Premises, 10% on Leasehold Premises. The stock on hand at 31st December was £84,400.

I. The following is the Trial Balance of J. Smith as at 31st December. Prepare Trading and Profit and Loss Accounts and Balance Sheet. The stock at the date of the Trial Balance amounted to £515:—

	Dr. £	*Cr.* £
J. Smith—Capital		620
Leasehold Premises	600	
Stock at beginning of year	312	
Purchases	940	
Sales		1,400
Returns Outward		120
General Expenses	190	
Wages	316	
Due by Customers	460	
Sundry Creditors		652
Cash	30	
Bank Overdraft		56
	£2,848	£2,848

J. From the following particulars relating to A. B., a solicitor, prepare his Balance Sheet at 31st December, 19.., and an account showing the profit for the year ending at that date:—

	£
Cash at Bank, Solicitor's Account	942
Cash at Bank, Clients' Account	572
Petty Cash Book Balance (*Cr.*)	9
Sundry Debtors	1,692
Sundry Creditors	250
Stationery, etc.	54
Rent, Rates and Telephone	228
Bank Charges	12
Travelling Expenses	54
Salaries	1,290
General Office Expenses	240
Commission Received	72
Postages and Telegrams	156
Furniture, Books, etc.	525
Capital Account at 1st January, 19..	1,700
Allowances to Clients	296
Fees	4,030

Reserve £42 for rent owing; £14 for stationery; £50 for accountancy charges; and £20 for general office expenses.

K. The following Trial Balance was extracted from the books of L. Pirrie as on 31st December:—

TRIAL BALANCE.

	£	£
Capital Account		9,000
Drawings Account	700	
Purchases	5,221	
Do. Returns		424
Sales		14,984
Do. Returns	182	
Stock, 1st January	1,146	
Salaries	628	
Manufacturing Wages	3,856	
Leasehold Factory	2,500	
Rent, Rates, and Insurance	694	
Carriage Inwards	231	
Do. Outwards	324	
Office Expenses	952	
Plant and Machinery	2,400	
Bad Debts Reserve (1st January)		324
Factory Fuel	795	
Discounts Received		118
Discounts Allowed	100	
Bills Receivable	124	
Sundry Debtors	3,897	
Sundry Creditors		1,698
Cash at Bank	1,240	
Do. in Hand	221	
Office Furniture	350	
Travellers' Salaries and Commission . . .	987	
	£26,548	£26,548

You are required to prepare therefrom Trading and Profit and Loss Accounts for the year ended 31st December, and a Balance Sheet as on that date.

Before preparing the accounts the following adjustments are necessary :—

1. Depreciation is to be written off as follows :—
   Leasehold Premises 5%, Plant and Machinery 10%, Office Furniture 5%.
2. The Reserve for Bad Debts is to be made up to £400.
3. The value of the Stock, as on 31st December, was £1,429.
4. Three days' Wages (amounting to £57) had accrued due, but had not been paid on closing the books.
5. Unexpired Insurance Premiums, amounting to £68, are to be carried forward to next year.

L. The following Trial Balance is extracted from the books of J. B. Clark, Miller and Corn Merchant, as on 31st December, 19..:—

TRIAL BALANCE.

	£	£
J. Clark, Capital Account		25,000
Do. Drawings	1,778	
J. Hill, Loan Account		5,000
Purchases	26,220	
Do. Returns		1,172
Sales		42,976
Sales Returns	84	
Freehold Mill	10,000	
Machinery and Plant (1st January)	8,740	
New Machinery purchased	1,296	
Motor Lorries	3,050	
Wages of Mill hands	6,785	
Office Salaries	1,942	
Stock (1st January)	9,876	
Rates and Taxes	191	
Sundry Debtors	12,860	
Sundry Creditors		5,112
Cash in Hand	276	
Bank Overdraft		5,000
Coal and Lighting (Mill)	398	
Office Expenses	321	
Travellers' Expenses and Commission	872	
Carriage Inwards	294	
Bad Debt Reserve (1st January)		480
Discounts Received		242
Discounts Allowed	200	
Bad Debts	384	
Cash Sales		1,296
Insurances	179	
Office Furniture	360	
Interest Account	172	
	£86,278	£86,278

You are required to prepare Trading and Profit and Loss Accounts for the year ended 31st December, 19.., and a Balance Sheet as on that date.

In addition to the particulars given above, the following matters must be taken into consideration when preparing the above accounts :—

(a) Depreciation is to be charged as follows :—
    Plant and Machinery (excluding the additions) 10%; Motor Lorries 20%; Office Furniture 5%.

(b) Make the Bad Debt Reserve up to £600.

(c) The Stock on hand, as on 31st December, 19.., was valued at £12,486.

(*d*) Unexpired insurance, as on 31st December, 19.., amounted to £38.
(*e*) J. Hill is entitled to 6% interest on his Loan Account, but no entries have been made in the books.

M. A. Flowers is in business as a Florist and Landscape Gardener. The following Trial Balance is extracted from his books at 30th September, 1940:—

TRIAL BALANCE.

	£	£
Capital Account		12,500
Freehold Nursery and Gardens	6,198	
Leasehold Warehouse and Offices	5,547	
Loose Tools	700	
Workmen's Wages	2,586	
Rent and Rates	870	
Purchases	9,642	
Sales		17,894
Receipts for Constructing Gardens		1,963
Stock (1st October, 1939)	3,861	
Purchases Returns		94
Sales Returns	39	
Carriage Inwards	127	
Carriage Outwards	98	
Insurance	118	
Office Salaries	697	
Discounts Received		137
Discounts Allowed	100	
Motor Lorries	1,900	
Office Furniture	320	
Loan on Mortgage, at 10 per cent.		2,000
Interest Account and Bank Charges	136	
Sundry Debtors	3,742	
Sundry Creditors		2,520
Heating and Lighting	107	
Advertising	975	
Bank Overdraft		462
Cash in Hand	107	
Reserve for Bad Debts (1st October, 1939)		300
	£37,870	£37,870

You are required to prepare Trading and Profit and Loss Accounts for the year ended 30th September, 1940, and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration:—

(*a*) Office salaries (£32) had accrued due as on 30th September, 1940, but had not been passed through the books.
(*b*) Insurance £12 had been paid in advance.
(*c*) Interest for the half-year to 30th September, 1940, on the Mortgage, had accrued due, but had not been passed through the books (ignore Income Tax).
(*d*) The following depreciation is to be provided: Motor Lorries, 15%; Loose Tools, 25%; Office Furniture, 5%; Leasehold Premises £547.
(*e*) The Reserve for Bad Debts is to be increased to £400.
(*f*) The Stock on hand as on 30th September, 1940, was valued at £4,062.

N. From the figures set out below, extracted from the books of a Retail Timber Merchant, you are required to prepare Trial Balance as at 31st December, 1940, Trading and Profit and Loss Accounts for the year ended 31st December, 1940, and Balance Sheet as at that date.

	£	s.	d.
Capital Account, Balance at Credit 1st January, 1940	2,076	4	8
Drawings, 1st January, 1940, to 31st December, 1940	318	18	4
Gas Account—Power	17	7	11
Postages and Stationery	16	19	1
Cartage	144	1	0
Bad Debts	2	12	5
Insurances	80	13	9
Wages and Salaries	631	15	6
Stock—1st January, 1940	1,412	9	6
Purchases	2,490	6	2
Sales	4,368	4	3
Rent, Rates and Taxes	299	13	10
Sundry and General Expenses	145	19	4
Electric Lighting	5	18	6
Discounts Received	4	2	11
Gas Account—Lighting	18	6	2
Plant and Machinery	306	2	4
Cash at Bank	322	10	0
Do. in Hand	64	5	4
Sundry Debtors	192	4	7
Sundry Creditors	21	11	11

The Stock at 31st December, 1940, was £1,199 14s. 10d. You have to take into account an amount owing for Rent £21 13s. 10d. and Insurance paid in advance £12 10s.

O. Show the Journal and Ledger entries to record the following:—

(*a*) 1940. Jan. 1. Bad Debts Reserve of £860 standing on the books.

(*b*) 1940. Dec. 31. Total of Bad Debts A/c. £1,000.

(*c*) do. Adjust the Reserve A/c. so that it may show a Reserve of 7½% on the Book Debts, which are £15,000.

(*d*) Assume that business has been continued for another twelve months, i.e., up to 31st December, 1941, and that the Bad Debts are then £1,100. Adjust the reserve, so that it may show a reserve of 7½% on the amount of the Book Debts, which are then found to be £12,674.

P. What system of Book-keeping would you recommend to a trader starting in business ? Explain the various books which should be kept, so as to enable him to ascertain in the shortest time and most reliable manner the results of his business operations.

Q. What is the difference between gross profit and net profit ? Illustrate your answer by means of *pro formâ* Trading and Profit and Loss Accounts applicable to the business of a timber merchant.

R. A trader keeps his books upon the double entry system. At the periodical stocktaking he extracts a Trial Balance from his ledger; and, after adjusting some errors, finds that the total of the debit balances equals the total of the credit balances. Is this agreement an absolute proof that the books are correct in every respect and that no further errors exist ? Give reasons for your answer. What further tests, if any, would you apply ?

CHAPTER V

BILLS OF EXCHANGE AND BILL BOOKS

In commercial transactions, manufacturers, producers and merchants commonly allow their customers an extended period in which to pay for goods delivered. For example, the agreed terms may be that payment shall be made " three months from date of delivery." Goods disposed of in this way are said to have been sold "on credit terms," but obviously the number of the seller's transactions would be very much restricted if, before he could again utilise the capital represented by the goods sold, he had to wait until he received payment at the expiration of the term of credit.

To overcome this difficulty Bills of Exchange were introduced as a means of settling transactions in which a period of credit is allowed. By arrangement with the purchaser, the seller draws on him a bill of exchange (usually spoken of as a " bill ") falling due for payment by the purchaser at the end of the agreed period. The instrument is " accepted " by the purchaser to signify that he agrees to pay it in due course, and is returned to the seller, who thus obtains the written undertaking of the purchaser to meet the debt incurred at the agreed future date.

Where the financial position of the parties is known to be good, the seller may, if he so desires, at once sell the bill to his bankers (i.e., " discount " the bill) and thereby obtain the present value of " the right to receive the money at a future date " which the bill represents. The amount of interest for the period intervening before the bill is due to be paid is deducted from the nominal sum payable, and is regarded as discount. In modern practice, bills of exchange possess three useful functions, i.e., they act :—(1) As an easy means of settling transactions between persons and firms in the same or different countries without the transfer of cash ; (2) as instruments of credit ; and (3) as legal evidence of a debt, enabling payment to be enforced in case of need without involved litigation.

Negotiable Instruments.

Bills of exchange (including cheques) and promissory notes, are negotiable instruments, and it will be convenient at this point to consider the characteristic features of negotiability.

A NEGOTIABLE INSTRUMENT is an instrument of which the transfer by delivery, or by indorsement and delivery, gives to a *bona fide* transferee for value an absolute title to the property in it, i.e., a title free from any defects in the title of a previous holder.

The requisites of negotiability are :—

(*a*) The instrument must be transferable by delivery, as, for example, a bearer bill or cheque (i.e., one payable to bearer), or by indorsement in addition to delivery, as in the case of an order bill or cheque (i.e., one payable to a named person). Thus no notice is required to be given to any party liable on the instrument in order that the transferee may obtain the benefit of such liability.

(*b*) The property in the instrument—that is to say, the rights—must pass free from defects in title.

(*c*) The holder must be able to sue in his own name. He must have all the rights to the instrument, and all that it represents.

Among the instruments recognised as negotiable by English Law are : bills of exchange, promissory notes, cheques, exchequer bills, dividend and share warrants, debentures payable to bearer, and certain scrip and bonds.

Statutory Definition of a Bill.

The Bills of Exchange Act, 1882, defines a bill of exchange as " an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer."

These requirements must be strictly observed, as the Act further provides that " an instrument which does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is not a bill of exchange." Consequently, it follows that the provisions relating to bills in the Bills of Exchange Act, 1882, do not apply to instruments which do not fall strictly within the definition.

It should be noted that the essential points relating to a bill are that :—

(*a*) It must be in writing (writing includes print and typewriting).

(*b*) The order must be unconditional, i.e., no conditions may be attached to the making of the payment ;

(*c*) It must be addressed by one person to another and must be an *order* to pay ;

(*d*) It must require payment to be made to a specified person, or to bearer;
(*e*) If the order is not to pay on demand there must be some fixed or determinable future time for payment;
(*f*) It must order payment of a sum certain *in money*; and
(*g*) It must be signed by the drawer.

The Act differentiates between an inland bill and a foreign bill. The former "is a bill which is or on the face of it purports to be (*a*) both drawn and payable within the British Islands, or (*b*) drawn within the British Islands upon some person resident therein." Any other bill is a foreign bill. For the purposes of the Act "British Islands" mean any part of the United Kingdom of Great Britain and Ireland, the islands of Man, Guernsey, Jersey, Alderney, and Sark, and the islands adjacent to any of them being part of the dominions of His Majesty.

Specimens of inland and foreign bills are given on pages 142 and 143.

Parties to a Bill.

The parties to a bill of exchange are :—

(1) THE DRAWER, i.e., the person to whom the money is owing and who draws the bill.

(2) THE DRAWEE, i.e., the person upon whom the bill is drawn and who upon signifying his acceptance of the terms of the bill becomes legally bound to meet it. When he accepts the bill he is known as the ACCEPTOR (see below).

(3) THE PAYEE, i.e., the person named on the bill as the one to whom the money is to be paid. If the bill is payable to the Drawer, then the Payee and Drawer are one and the same person. Where the Payee transfers the bill by delivery coupled with indorsement he is known as the INDORSER (see below).

A BEARER is the person in possession of a bill which is payable to bearer.

A HOLDER is the payee or indorsee of a bill who is in possession of it, or the bearer thereof.

A HOLDER FOR VALUE is the holder of a bill for which value has at any time been given.

A HOLDER IN DUE COURSE is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely :—

(*a*) That he became the holder of it before it was overdue, and without notice that it had been previously dishonoured, if such was the fact.

(*b*) That he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it. (Section 29, Bills of Exchange Act, 1882.)

THE ACCEPTOR is the person who is primarily liable upon a bill. By accepting, he engages to pay it according to the tenor of his acceptance, and he is precluded from denying to a holder in due course :—

(*a*) The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the bill.
(*b*) In the case of a bill payable to the drawer's order, the then capacity of the drawer to indorse, but not the genuineness or validity of his indorsement.
(*c*) In the case of a bill payable to the order of a third person, the existence of the payee and his then capacity to indorse, but not the genuineness or validity of his indorsement. (Section 54, Bills of Exchange Act, 1882).

THE DRAWER of a bill engages that, on due presentment, it shall be accepted and paid according to its tenor, and that if it is dishonoured, he will compensate the holder or any indorser who is compelled to pay it, provided that the requisite proceedings on dishonour have been duly taken.

AN INDORSER (OR ENDORSER) of a bill of exchange, by indorsing it, engages that on due presentment, it shall be accepted and paid according to its tenor, and that if it is dishonoured, he will compensate the holder or a subsequent indorser who is compelled to pay it, provided that the requisite proceedings on dishonour are duly taken.

Acceptance.

The Bills of Exchange Act, 1882, defines acceptance of a bill as " the signification by the drawee of his assent to the order of the drawer." It is effected by the drawee's writing the word " accepted " across the face of the bill, and adding his signature. Legally the drawee's signature alone is sufficient, but in practice the word " accepted " and the date are frequently added, and the place of payment is generally stated, as in the following or a similar form :—

Accepted
Payable at Barclay's Bank, Ltd.,
Fenchurch Street, London.
A. Phillips.
17*th January*, 19 . .

In the case of a bill which is payable "after sight," i.e., after the date of presentment to the drawee for acceptance, the date of acceptance is essential in order to fix the maturity of the instrument.

The specimen acceptance given on page 133 is a "general" acceptance, i.e., one which assents without qualification to the order of the drawer. A qualified acceptance is one which varies the effect of the bill as drawn, and may be—

(a) *Local*—payable at a particular place and *there only*.
(b) *As to time*—lengthening or lessening the period of the bill, e.g., payment to be in six, not three months.
(c) *Partial*—accepted for payment of part of the amount only.
(d) *As to Parties*—acceptance by one or more of two or several drawees only.
(e) *Conditional*—acceptance subject to fulfilment of a specified condition, e.g., delivery of documents.

If the acceptance is clear and unequivocal on the face of the bill, payment need be made only in accordance therewith by the acceptor, who cannot, however, promise payment in any way except in money.

The holder of a bill may refuse to take a qualified acceptance, and if he does not obtain an unqualified acceptance, is entitled to treat the bill as dishonoured by non-acceptance. In fact, if he *does* take a qualified acceptance without the express or implied authority or assent of the drawer and indorsers (if any), they are released from liability. Of course, if the bill has not left the drawer's hands, he is the only interested party and can act as he chooses.

A *partial* acceptance (c) must not, however, be refused, and instead of notice of dishonour, notice of the qualification *must* be given to all parties.

Indorsement.

Where a bill is drawn to the "order" of the drawer, the latter must *indorse* it, i.e., he must write his signature on the back of the bill, thus becoming the first indorser. The bill may, however, be drawn, or, if not so drawn, indorsed to the order of a third party who, when he adds his signature to the bill, also becomes an "indorser."

Indorsements may be—

(1) In Blank, where the holder simply writes his signature on the back of the bill.
(2) Special, where the holder names the person to whom, or to whose order, the bill is to be payable, e.g., "Pay X. Y. or order."

(3) RESTRICTIVE, where the indorsement makes the bill payable to a specified person, and prohibits further negotiation, e.g., Pay X. Y. *only.*

In modern practice, bills of exchange are extensively negotiated. Each holder may, by special indorsement, designate the person to whom he wishes payment to be made, and the indorsee must, in his turn, also indorse the bill before transferring it or before he can receive payment. When the back of the bill is covered by successive indorsements, a gummed slip (termed an "Allonge") is attached to the bill to provide space for further indorsements. The person attaching the allonge should sign partly on the allonge and partly on the bill, so as to obviate fraud.

Term of Bills and Days of Grace.

Inland Bills are usually drawn for a stated period after date, but foreign bills are variously drawn "on demand," "at sight," "after date" or "after sight."

"On demand" and "at sight" both mean that bills so drawn are payable upon presentation to the drawee or acceptor. For bills drawn "after date," the period begins to run from the date of the bill, but for those drawn "after sight," the term of the bill runs from the date of "sighting," which must be stated in the acceptance, and the due date is calculated accordingly. The term "month" in a bill means calendar month.

For bills payable in the United Kingdom (other than those drawn "on demand" or "at sight") three days, called "days of grace," are added to the nominal term of the bill, which becomes due and payable on the last day of grace (e.g., a bill drawn on 5th February, at four months, falls due for payment not on 5th June, but on 8th June). Similarly, a bill drawn on 28th December at two months falls due for payment on 3rd March. Days of grace may be excluded if the bill is specially drawn to this effect, e.g., "one month after date *without grace*, pay, etc."; "or on 22nd June *fixed*, pay, etc." When the last day of grace falls on a Sunday, Good Friday or Christmas Day, or on a day appointed as a public holiday by Royal Proclamation, the bill is payable on the last *preceding* business day. If, however, the last day of grace is a bank holiday (other than Christmas Day or Good Friday), or if the last day of grace is a Sunday and the second day of grace a bank holiday, the bill is payable on the *succeeding* business day.

Signatures in a Representative Capacity.

Where bills are signed by persons in a representative capacity, either as drawer, acceptor or indorser, it is essential that some

word or words be added to indicate the representative capacity and thus avoid personal liability. For sole traders or partnerships this is usually shown by a procuration signature, thus :—

per pro A. Phillips & Co.
J. W. Browning, *Partner.*

For limited companies the following form is generally adopted :—

For and on behalf of Traders, Limited,
B. Smith, *Director.*

Presentment for Payment.

At its due date the holder of the bill (or, more usually, his banker) presents the bill for payment at the place of payment stated in the acceptance, or, if no place is stated, to the acceptor at the address given on the bill, or, if no address is given, then at the acceptor's place of business, if known, or at his ordinary residence. If the bill is not accepted when presented for acceptance, or paid when it falls due, by the acceptor or by his agent, it is said to be *dishonoured*, by non-acceptance or non-payment respectively, and the holder has a right of recourse against previous indorsers and the drawer if he gives them prompt notice.

Noting and Protesting.

On dishonour, a bill is usually "noted," i.e., it is handed to a notary public, who re-presents the bill to the acceptor (or his banker) for acceptance or for payment, as the case may be, and thus formally obtains independent evidence of its dishonour. The notary records particulars of the bill, its re-presentment, and the "answer" or reason for non-acceptance or for non-payment. A small slip, bearing the notary's name, is attached to the bill, summarising these particulars, and bearing a note of his fee, the answer given, and his initials.

If a foreign bill is dishonoured, it is legally necessary, in addition to noting, to "protest" the bill in order to preserve the holder's rights against the drawer and previous indorsers. A protest is a formal record of dishonour, embodying a copy of the bill and the particulars on the "slip" previously mentioned; it is not essential in the case of an inland bill.

Foreign and Documentary Bills.

Foreign bills are usually drawn in a set of three, all three parts being identical, except that only one part should be accepted and stamped. The parts form only one bill, but in the event of the delay or loss in transit of one of the parts, the second or

third copy may be acted upon by the parties. In many cases such bills are accompanied by the shipping documents relating to the goods against which the bills are drawn, viz., the bill of lading, insurance policy, invoice, and (where required) certificate of origin or consular invoice. The bill of exchange is then known as a *documentary bill.*

Such bills may be handed to a banker for collection, with instructions to surrender the shipping documents against acceptance or payment by the drawee of the bill, who is generally the consignee of the goods, but, more usually, the drawer obtains an advance from his banker against the shipment, the banker taking the documents as security. For his own protection, the banker sometimes requires the drawer to sign a "letter of hypothecation," pledging the goods as security for the advance, and conferring upon the banker the right to deal with the goods in the event of the bill being dishonoured.

Where the consignee's (or buyer's) financial position is good, the bill will be marked D/A, i.e., documents against acceptance, and the shipping documents will then be released by the banker upon acceptance of the bill. Otherwise the consignee or buyer (the drawee of the bill) can obtain the documents only upon payment (the bill is then marked D/P, i.e., documents against payment). If the vessel carrying the goods arrives before the due date of a D/P bill, and the consignee wishes to obtain the documents so that he can take possession of the goods, he may take up the bill *under rebate*, i.e., pay the amount of the bill, less an allowance for interest in respect of the unexpired term of the bill. Alternatively, arrangements may be made for the storage of the goods at the dock warehouse in the banker's name (charges being payable by the consignee) until the due date, when upon payment of the bill, the goods are released to the order of the consignee.

Usance.

The customary period for which bills are drawn between certain countries is termed the "usance." This originated in the custom of merchants and depended upon the average period of time occupied in transit between the two countries concerned, and the time required to sell the goods after arrival at their destination. For example, the usance between New York and London is sixty days after sight. Owing to the increased rapidity of international communication, however, usance is becoming obsolete, and bills are usually drawn at so many "days after sight," as arranged between the parties at the time of the sale.

Various Clauses on a Bill.

In varying circumstances, certain clauses or phrases are used on bills. Inland bills are sometimes marked N/N, meaning

"not to be noted," and indicating the drawer's wish that the expense of noting is not to be incurred. With foreign bills the phrase "*sans frais*" is used, and constitutes an instruction to the holder that, in the event of dishonour, the bill is to be returned "without expense," i.e., without being subject to charges for noting and protesting.

Another phrase used in the negotiation of bills is "*sans recours*" (without recourse), indicating that the indorser against whose name the words appear, negotiates the bill on the basis that he incurs no liability if the bill is dishonoured.

Foreign bills drawn in the United Kingdom on the colonies or foreign countries, and handed to bankers for collection, are frequently enfaced with a clause such as the following :—

> "*Payable with approved banker's cheque on London for full face value.*"

This ensures that the payee receives the sterling amount of the draft, and the foreign drawee must pay over sufficient in his own currency to the local banker to purchase the necessary cheque or demand draft on London for the face value of the bill for collection.

Referee in Case of Need.

It is sometimes the practice for the drawer to mark bills as follows :—

> "*In case of need apply to . . .*"

naming an agent or friend of his who will act on his behalf in event of dishonour or other difficulty. Such a person is known as a "referee in case of need."

In the event of dishonour by non-acceptance, the referee will intervene and accept the bill, *supra protest*, for the honour of his principal. The acceptor for honour engages that he will, on due presentment, pay the bill according to the tenor of his acceptance, if it is not paid by the drawee, provided it has been duly presented for payment and protested for non-payment, and that he receives notice of these facts. The acceptor for honour is liable to the holder and to all parties to the bill subsequent to the party for whose honour he has accepted.

Accommodation and House Bills.

By far the greater proportion of bills drawn and negotiated are in respect of legitimate trade transactions, and such bills greatly facilitate the operations of traders and merchants, and also provide employment for the surplus funds of bankers and bill brokers. There are, however, two other classes of bills

occasionally met with, viz., "Accommodation" Bills and "House" Bills.

ACCOMMODATION BILLS (also termed "kites" and "windmills") are drawn merely for the purpose of obtaining temporary monetary accommodation for either the drawer or the acceptor, and although worded "for value received," do not represent genuine trading transactions; in other words, no valid consideration passes between the principal parties, and the drawer or acceptor, as the case may be, "lends" his name to the other. The bill is discounted by the party accommodated, who must provide the acceptor with funds to meet the bill at its due date.

HOUSE BILLS are in effect accommodation bills drawn by the head office of a trading firm or company upon one of its branches or agencies, or by the latter upon the head office, and are discounted to supply the drawer with funds for trading operations.

PROMISSORY NOTES

The Bills of Exchange Act, 1882, defines a promissory note as "an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer."

Promissory notes, like bills of exchange, are negotiable instruments, and are usually drawn to the order of a specified person. In commercial circles, "bearer" promissory notes are rarely met with, but it should be noted that, from a legal view-point, Bank Notes are "bearer" promissory notes. When drawn "to order" a promissory note requires indorsement by the payee in the usual manner.

All promissory notes, whether payable on demand or not, must bear *ad valorem* stamps at the same rates as for bills of exchange payable after date.

The stamps must be impressed on inland notes whether payable on demand, at sight or on presentation, but are adhesive on foreign notes. Bank of England notes are exempted by statute from stamp duty.

Like bills of exchange, promissory notes are a convenient means of settling transactions, but they are more often utilised as collateral security for loans. Their use in the United Kingdom is comparatively limited, bills of exchange being used much more generally.

Promissory notes are drawn and issued by the debtor, who is termed the "maker" of the note and corresponds with the

" acceptor " of a bill, while the payee and indorser of a promissory note correspond with the payee and indorser of a bill.

Many of the provisions of the Bills of Exchange Act relating to bills of exchange apply also to promissory notes, but the following distinctions between bills and promissory notes should be carefully noted :—

BILLS OF EXCHANGE.	PROMISSORY NOTES.
1. Bills require acceptance.	1. No acceptance is required, so notes are not accepted for honour nor presented for acceptance.
2. The acceptor is the principal debtor ; the drawer being only secondarily liable.	2. The maker is the principal debtor.
3. Bills are sometimes drawn in a set.	3. Promissory notes are never drawn in a set.
4. A bill is an order to pay.	4. A note is a promise to pay.
5. Protest is sometimes necessary (e.g., foreign bills).	5. Foreign notes do not require protesting.
6. Acceptance of a bill may be made conditionally by the principal debtor.	6. A note cannot be drawn conditionally by the maker.
7. Two acceptors of a bill are liable jointly (see page 167).	7. Two or more makers *may* be liable jointly and severally.
8. A bill on demand requires a twopenny stamp, whatever the amount.	8. *All* promissory notes require *ad valorem* stamps.

Stamp Duties on Bills and Notes.

By the Stamp Act, 1891, and various amending acts which have since been passed, the principal being the Finance Act, 1918, bills of exchange, promissory notes, and cheques are required to be legally stamped before they are valid and legally enforceable. The stamp duties are as follows :—

BILLS OF EXCHANGE.

(1) When payable on demand, or at sight, or on presentation, or not exceeding three days after date or sight, for any amount . . . . . 2d.

In the case of inland bills this stamp may be either adhesive or impressed, while on foreign bills it is adhesive, and may consist of (*a*) an ordinary foreign bill stamp ; or (*b*) postage stamps.

(2) On all others—

Where the amount does not exceed £10	2d.
Where it exceeds £10 and does not exceed £25	3d.
" " " £25 " " " " £50	6d.
" " " £50 " " " " £75	9d.
" " " £75 " " " " £100	1s.
" " " £100, for each £100 or any part thereof . .	1s.

Inland bills under this heading must be drawn on impressed stamp paper ; foreign bills must be stamped with *adhesive foreign bill stamps.*

EXCEPTION: (FINANCE ACT, 1899, SECTION 10).

Bills, other than those under (1), drawn and expressed to be payable out of the United Kingdom, but actually paid, indorsed or negotiated in any manner within the United Kingdom, are stamped as inland bills if the amount of the bill does not exceed £50, but

Where it exceeds £50 and does not exceed £100	6d.
Where it exceeds £100, for every £100 or part thereof . .	6d.

PROMISSORY NOTES.

Inland promissory notes, whether payable on demand or not, must bear *ad valorem impressed* stamps. Foreign notes must bear *adhesive* "foreign bill or note stamps" in accordance with (2) above.

CHEQUES.

For any amount, adhesive or impressed stamps . . . . . . 2d.

In practice, inland bills or notes are generally drawn upon paper which bears the requisite impressed stamp.

Where a bill requires the drawee to pay interest at a given rate per cent. as well as the principal, the stamp duty is calculated on the principal only.

If, however, the interest is calculated and the amount actually stated, stamp duty is payable on the total of both bill and interest.

Foreign bills must bear the appropriate adhesive foreign bill stamps, which must be affixed thereto by the first person into whose hands the bills come for negotiation on arrival in this country.

As mentioned previously, for the purpose of the Bills of Exchange Act, 1882, an inland bill is one both drawn and payable in the British Islands or drawn in the British Islands on a person resident therein and all other bills are foreign bills. For purposes of stamp duty, however, all bills, whether inland or foreign, must be stamped at the ordinary rate (1s. for each £100 or part thereof) unless they are both drawn *and expressed to be payable* outside the United Kingdom, but actually paid, indorsed or negotiated in the United Kingdom, in which case, they should be stamped at the lower rate (6d. for each £100 or part thereof).

The adhesive "foreign bill stamp" may be affixed only to a "bill of exchange or promissory note drawn or made outside the United Kingdom." (Stamp Act, 1891, Section 35.)

It may be added that nearly all the British Colonies and most foreign countries have their own particular stamp duties in force, but consideration of these duties is outside the scope of the present volume.

Forms of Bills of Exchange and Promissory Notes.

The following are specimen forms of Bills of Exchange :—

INLAND BILL OF EXCHANGE

No. 1.

£150 15 6 LONDON, 1*st September*, 19..

Three months after date pay to our Order the sum of One hundred and fifty pounds, fifteen shillings and sixpence. . . . . Value received.

To MR ARTHUR BROWN, 51 HIGH STREET, NEWTOWN.

per pro A. PHILLIPS & CO. *J. W. Browning* (Partner).

The above bill would be accepted by A. Brown writing across the face of the bil "Accepted, Arthur Brown, 6th September 19..."

FIRST OF EXCHANGE OF BILL DRAWN IN A SET

No. 2.

(On First of Exchange only, the Second and Third are not stamped.)

Exchange *for* **£250 12 0** QUEBEC, 1*st September*, 19

At sixty days after sight of this **First of Exchange** (*Second* and Third not paid*) *pay to ourselves or order Two hundred and fifty pounds, twelve shillings. Value received per s.s. " Ophir."*

To MESSRS W. HEYWOOD & CO., LONDON.

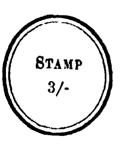
per pro L. DOWNING & CO. *S. T. Evans.*

* The Second of exchange will be worded "First and Third not paid," and the Third of exchange " First and Second not paid."

For the purpose of the Bills of Exchange Act this is a foreign bill, but as it is payable inside the United Kingdom the stamp duty is the ordinary 1s. per cent.

FIRST OF EXCHANGE OF BILL FOR COLLECTION OR NEGOTIATION

No. 3. **£285 0 0** LONDON, 1*st September*, 19..



Sixty days after sight pay this **First of Exchange** (*Second and Third unpaid*) *to our order the sum of Two hundred and eighty-five pounds Sterling payable at the National Bank of India's drawing rate for Demand Drafts on London with interest at Four per cent. per annum added thereto from date hereof to approximate due date of arrival of the remittance in London, value received.*

To MESSRS BLACK & JONES, MERCHANTS, CALCUTTA.

For and on behalf of TRADERS, LIMITED.
W. Black, Director.
A. Smith, Secretary.

For the purposes of the Bills of Exchange Act this is a foreign bill, but as it is drawn inside the United Kingdom the stamp duty is the ordinary 1s. per cent.

BILL DRAWN ABROAD ON PERSON RESIDENT ABROAD BUT ACTUALLY INDORSED IN THE UNITED KINGDOM

STAMP
3/6

No. 4. **$2,440** CAPE TOWN, *7th November*, 19..

Three months after sight of this First of Exchange (*Second and Third of same tenor and date being unpaid*) *pay to our Order the sum of two thousand four hundred and forty dollars for value received.*

To MR A. SMALLEY,
NEW YORK.

per pro L. JOHNSON & Co.
S. Allman (*Partner*).

NOTE.—The rate of exchange has been taken at 4 dollars to the £. This is a foreign bill "drawn and expressed to be payable outside the United Kingdom," and as it has been indorsed in the United Kingdom it must be stamped at the lower rate of 6d. per cent. The stamp must be affixed before the bill is indorsed or otherwise dealt with in this country. The sterling value of the bill for stamp duty purposes is computed on the basis of the rate of exchange ruling on the date of the bill. The bill would have been stamped in accordance with the law of the country in which it was drawn and would, also, have to be stamped in accordance with the law of the country in which it is payable.

BILL DRAWN IN THE CHANNEL ISLANDS ON PERSON RESIDENT IN THE ISLE OF MAN BUT ACTUALLY NEGOTIATED IN THE UNITED KINGDOM

STAMP
2/-

No. 5 £316 10 6 JERSEY, *2nd May*, 19..

Two months after date pay to my Order the sum of Three hundred and sixteen pounds ten shillings and sixpence for value received.

To MR F. ALLEN,
DOUGLAS,
ISLE OF MAN.

A. Tomlinson.

For the purposes of the Bills of Exchange Act this is an inland bill (both drawn and payable in the British Isles) but as it is both drawn and payable outside the United Kingdom it is only liable at the lower rate of 6d. per cent. for stamp duty purposes.

The following are specimen forms of Promissory Notes :—

STAMP.
9d.

£51 0 0 LONDON, *1st September*, 19..

At three months after date I promise to pay James Edwards & Co. or order the sum of Fifty-one pounds sterling, value received

ALBERT SMITH.

STAMP
3/-

£210 0 0 MANCHESTER, 23rd *July*, 19..

On demand we promise to pay to A. Thorpe & Co. the sum of Two hundred and ten pounds for value received.

J. NICHOLLS,
L. TAYLOR.

Note that Promissory Notes, whether payable on demand or not, must bear *ad valorem* stamps at the same rates as for bills of exchange payable after date.

The Books in which Bill Entries are Made.

The whole of a trader's transactions in bills of exchange may be adequately recorded in the journal and ledger; but in practice this is done only in small businesses, and a trader or firm whose dealings in bills are numerous makes the original entries in one of two specially ruled books, termed the "Bills Receivable Book" and the "Bills Payable Book" respectively; again adopting the convenient system of the subdivision of the journal and the classification of transactions of a similar nature into groups for entry into a separate book.

As indicated above, the books are ruled into special columns, designed to give all necessary information regarding each bill; specimens of each book are given on pages 146 and 147, and it will greatly assist the reader in memorising the rulings if the use of each column is described in detail :—

Bills Receivable Book.

(*a*) *Serial Number of Bill.* This number, given to each bill on receipt, facilitates reference to the actual bill in the bill-folder or portfolio, and is a short and handy "title" for use in correspondence and for identification.

(*b*) *Date Received.* Explanation is unnecessary, it being an accepted principle that all book-keeping transactions must be dated.

(*c*) *From Whom Received.* This column records the name of the debtor who has given the bill in full (or partial) settlement of his indebtedness, and indicates the personal account to be credited with the amount of the bill.

(*d*) *Drawer.* Although in the example this is "Self" in each case, it will not always be so; the name here indicates one of the essential parties to the bill, who may be held liable on dishonour.

(*e*) *Acceptor.* The importance of this column needs no emphasis, as the acceptor is the person primarily liable, to whom all parties look for payment in due course.

(*f*) *Place of Payment.* The insertion of this information obviates delay on presentation as the bill can be

forwarded to the correct "domicile" in the first instance.

(*g*) (*h*) and (*j*). Although the particulars in any one of these columns can be calculated from the other two, the use of the three columns gives all the necessary information at a glance.

(*k*) *Ledger Folio.* These figures record the folio in the ledger containing the personal account of the person forwarding the bill; this account must, of course, be credited as indicated in (*c*) above.

(*l*) *Amount of Bill.* This column indicates the amount to be credited to the personal account (see (*c*) above) for each bill, and, when totalled periodically—usually monthly—the amount to be debited to the Bills Receivable Account in the General Ledger.

(*m*) *Disposal.* This is a space for memoranda recording the disposal of the bill, which may be retained until maturity, when it is either paid or dishonoured; discounted, before maturity, with the bank; or indorsed over to a creditor in reduction of a debt owing to him by the trader.

The two additional columns mentioned at the foot of the example are self explanatory; they are extremely useful, as they give further information regarding the bill, and also act as a check upon the cash book entries.

Bills Payable Book.

(*a*) *No. of Bill.* The necessity for this column is indicated in (*a*) above.

(*b*) *Date Accepted.* This column records the date the bill was accepted.

(*c*) *Drawer.* The drawer is the creditor whose personal account is debited with the amount of the bill, as he is the person to whom the value of the bill is given (whether he transfers the bill to another or not matters little to the acceptor).

(*d*) *To Whom Payable.* This column serves to identify the bill more completely.

(*e*) *Where Payable.* In the absence of special arrangement, bills are usually accepted payable at the acceptor's bank; this column records both the usual course and deviations therefrom, and enables the necessary arrangements for payment to be made.

(*f*) *Date of Bill.*
(*g*) *Term.*
(*h*) *Due Date.*

In the case of a bill payable the last (due date) is extremely important, as only by arranging for prompt payment of every bill is damage to the credit of a firm avoided.

The remaining columns are sufficiently described under "Bills

BILLS RECEIVABLE BOOK.

(a) No. of Bill.	(b) Date received.	(c) From whom received.	(d) Drawer.	(e) Acceptor.	(f) Where Payable.	(g) Date of Bill.	(h) Term.	(j) Date due including Days of Grace	(k) Folio in Sales Ledger.	(l) Amount of Bill. £	s.	d.	(m) Disposal.
1	19.. Jan. 1	A. Brown	Self	A. Brown	Barclays, Hendon	19.. Jan. 1	3 months	19.. April 4	73	200	0	0	Discounted, 2nd January
2	„ 4	C. Dukes	„	C. Dukes	Lloyds, Watford	„ 4	4 „	May 7	184	150	0	0	Cash received, 7th May.
3	„ 24	E. Fox	„	E. Fox	Barclays, St Albans	„ 24	6 „	July 27	296	75	0	0	Discounted, 29th January.
							To Bills Receivable		Account	£425	0	0	

Each item entered in the above book is posted to the credit of the account of the person from whom the bill was received, the total of column (*l*) being periodically posted to the debit of the Bills Receivable Account in the General Ledger. Two additional columns may be added if required, to show the amounts received on, and the amounts charged for, discounting the bills.

BILLS PAYABLE BOOK.

(a) No. of Bill.	(b) Date accepted.	(c) Drawer.	(d) To whom payable.	(e) Where payable.	(f) Date of Bill.	(g) Term.	(h) Due date.	(j) Fol. in Bought Ledger.	(k) Amount. £	s.	d.	(l) How dealt with.
1	19.. Jan. 2	G. Free	G. Free	Barclays Bank, Fenchurch St.	19.. Jan. 1	2 months date	19.. March 4	86	175	10	0	Paid at maturity.
2	,, 6	H. Brown	Bank of London	,,	,, 1	3 ,,	April 4	29	52	0	0	Retired under rebate, 25th March.
3	,, 21	C. Black	C. Black	,,	,, 17	2 ,,	March 20	32	225	0	0	Paid at maturity.
4	,, 24	G. Free	G. Free	,,	,, 23	6 ,,	July 26	86	200	0	0	Paid at maturity.
							By Bills Payable	Account	£652	10	0	

Each item entered in the above book is posted to the debit of the account of the person to whom the bill is given, the total of column (k) being periodically posted to the credit of the Bills Payable Account in the General Ledger.

Receivable Book" above; the amount of each individual bill is posted to the debit of the creditor's account in the personal ledger, and the periodical total is credited to the "Bills Payable Account" in the General Ledger.

It may be noted here that in the Bills Receivable Book there is no column for "to whom payable," and in the Bills Payable Book no column for "acceptor"; in both cases the name of the trader or firm would be filled in, and it is therefore a waste of time and space (in the case of a bill receivable another person may be expressed on the bill as the payee, but the right has been negotiated to the holder, i.e., the trader or firm in whose books the entry is made).

The items shown in the bill books on pages 146 and 147 would appear in accounts in the General Ledger as shown below, it being assumed that no bills were outstanding on the 1st January, and that the books were closed on the 31st March for the preparation of the annual accounts.

Dr BILLS RECEIVABLE ACCOUNT. Cr.

19..			£ s. d.	19..			£ s. d.
Jan. 31	To Sundries		425 0 0	Jan. 2	By Cash and Discount.		200 0 0
				,, 29	,, Cash and Discount.		75 0 0
				Mar. 31	,, Balance	c/d.	150 0 0
			£425 0 0				£425 0 0
Apr. 1	To Balance	b/d.	150 0 0	May 7	By Cash		150 0 0

Dr. BILLS PAYABLE ACCOUNT. Cr.

19..			£ s. d.	19..			£ s. d.
Mar. 4	To Cash		175 10 0	Jan. 31	By Sundries		652 10 0
,, 20	,, ,,		225 0 0				
,, 25	,, Cash and Discount		52 0 0				
,, 31	,, Balance	c/d.	200 0 0				
			£652 10 0				£652 10 0
July 26	To Cash		200 0 0	Apr. 1	By Balance	b/d.	200 0 0

NOTE.—At 31st March, the balance on the Bills Receivable Account (£150) is shown as an asset, and the balance of the Bills Payable Account (£200) appears as a liability in the Balance Sheet.

Discounting Bills Receivable.

When bills receivable are discounted with a bank, the discount is charged on the full amount of the bill, in accordance with the following formula :—

$$\frac{\text{Amount of Bill}}{1} \times \frac{\text{Rate of Interest}}{100} \times \frac{\text{Days between date of discounting and maturity.}}{365}$$

In calculating the number of days between the date of discounting and maturity either the date of discounting or the date of maturity must be omitted. Thus, if a bill maturing on 15th February (i.e., 18th February, allowing for the days of grace) is discounted on 3rd January, the number of days for which interest is charged will be 46—January 28; February 18 —not 47.

This discount is known as bankers' discount or mercantile discount in contradistinction to true or theoretical discount, which is the difference between the true present value and the amount of the bill. The true discount may be ascertained by the following formula :—

$$\frac{\text{Amount of Bill} \times \text{Rate of Interest} \times \text{Time in Years.}}{100 + (\text{Rate of Interest} \times \text{Time in Years}).}$$

This form of discount is not used in practice, the amount of discount deducted by the banker on discounting a bill being calculated in accordance with the formula given on the previous page.

When a bill is discounted, the necessary entries are :—

Debit the Cash Book ("Bank" column) with the *full* face value of the bill and *credit* the Cash Book ("Bank" column) with the discount. The Bills Receivable Account is *credited* with the full amount of the bill, and the discount *debited* to Banker's Discount Account (or Bank Charges and Interest Account, if the number of transactions does not warrant a special account being opened for interest). The balance on Banker's Discount Account will be transferred to the debit of Profit and Loss Account at the end of the trading period.

It is desirable that the Discount Account in the General Ledger should include only the cash discount allowed to customers or by creditors, and consequently the charge made by bankers in connection with the discounting of bills should not be recorded in the cash discount column of the Cash Book, but recorded in the manner indicated above. The adoption of the method outlined above will ensure that the banker's discount or interest will eventually reach its proper destination, instead of being diverted to the ordinary Discount Account, and also enables the entries in the Cash Book to be more easily verified with the entries in the bank pass book, for it is the practice of bankers to record the two entries in the customer's account separately and not merely to credit him with the net amount allowed for the bill.

EXAMPLE.

On 1st March, *A* sells goods to *B* for £250, and *B* accepts a bill of exchange for this amount, payable in three months. On 16th March, *A* being in need

of the money, discounts the bill with his bankers at 5% per annum discount. The bill is duly met at maturity. Find the amount of the discount charged by the bank, and enter the transactions in *A's* Ledger.

The amount of discount is calculated as follows :—

$$\frac{£250}{1} \times \frac{5}{100} \times \frac{80^*}{365} = £2\ 14s.\ 9d.$$

* The number of days includes the three days of grace, and covers 17th March to 4th June, *inclusive.*

Dr. B's ACCOUNT. *Cr.*

			£ s. d.			£ s. d.
19..				19..		
Mar.	1	To Sales* .	250 0 0	Mar. 1	By Bills Receivable .	250 0 0

* The corresponding credit is included in the periodical posting to Sales Account.

Dr. BILLS RECEIVABLE ACCOUNT. *Cr.*

			£ s. d.			£ s. d.
19.				19..		
Mar.	1	To B. .	250 0 0	Mar. 16	By Bank .	250 0 0

Dr. CASH BOOK (BANK COLUMN). *Cr.*

			£ s. d.			£ s. d.
19..				19..		
Mar.	16	To Bills Receivable Discounted .	250 0 0	Mar. 16	By Banker's Discount .	2 14 9

Dr. BANKER'S DISCOUNT ACCOUNT. *Cr.*

			£ s. d.			
19..						
Mar.	16	To Bank .	2 14 9			

Retiring Bills of Exchange.

It sometimes happens that a trader who is liable on a bill wishes to pay or "retire" the bill before its due date. This occurs, more usually, with merchants who have made purchases of colonial or foreign produce on the terms "Documents against Payment," or "Cash against Documents." Upon presentation, the draft is accepted by the drawee, and is recorded in the usual way in his Bills Payable Book. Later, upon arrival of the steamer, the merchant may "take up" the documents and pay the bill, less an allowance for the unexpired term.

It is evident that the effect of this is exactly the reverse of discounting a bill with the bank, for the trader now receives an allowance for making a payment before it is due. This transaction may therefore be recorded by (i) crediting Cash (Bank column) and debiting Bills Payable Account with the full face value of the bill, and (ii) debiting Cash (Bank column) and crediting Rebate on Bills Account with the amount of the interest allowed by the bank. The balance on Rebate on Bills Account will be transferred to the credit of Profit and Loss Account at the end of the trading period.

In the books of the person holding the bill (e.g., the payee) the retirement of a bill receivable will be treated in a similar manner to that already explained on page 149 for bills discounted but in place of Banker's Discount Account the amount allowed for rebate is debited to Discount Account.

The retirement of bills of exchange, however, is not confined to foreign bills; it may (and frequently does) occur with inland bills when the acceptor finds that he has sufficient funds available.

The Treatment of Bills Receivable.

Ordinarily, bills receivable are either discounted or handed to a banker for collection at maturity. The entries required to record discounting transactions are shown on pages 149 to 150; when bills are collected by the bank, the procedure is to debit the bank column in the Cash Book and credit Bills Receivable Account.

For bills drawn on colonial or foreign customers against goods shipped to them, the trader may adopt one of the following methods:—

(1) Sell the bill outright to his banker;

(2) Hand the bill to his banker with instructions to collect; or

(3) Obtain an advance from his bank upon the security of the shipment, a final settlement being effected when the banker has received the proceeds of the bill from his colonial or foreign agent.

By the first method, the Cash Book (Bank column) is debited and Bills Receivable Account is credited, the discount or other charges for negotiation being credited to the bank column in the Cash Book and debited to Bank Charges (or Banker's Discount) Account.

With the second method, a separate account is opened in the ledger headed with the name of the bank and a sub-heading—

"BILLS FOR COLLECTION ACCOUNT."

To this account is debited, from time to time, the amount of the bills handed to the bank for collection, Bills Receivable Account being credited. When the proceeds are received, the Cash Book (Bank column) is debited with the full amount, and the Bank Bills for Collection Account is credited, any charges incurred being credited to the Cash Book (Bank column) and debited to Bank Charges Account in the ledger.

For the third method a Bank Bills for Collection Account is also opened, and debited with the full amount of the bills, Bills Receivable Account being credited. The amount received as an advance is debited to the Cash Book (Bank column) and credited to the Bank Bills for Collection Account. When the final settlement is effected, the gross balance due is debited to Cash Book (Bank column), and the Bank Bills for Collection Account is credited and closed. The bank charges are credited to the Cash Book (Bank column) and debited to Bank Charges Account.

Dishonoured Bills.

It sometimes happens that when a bill is presented for payment, the person on whom the bill was drawn is not in a position to meet it; the bill is then said to be dishonoured. The entries necessary to record the dishonour will depend on how the bill has already been treated in the books. The main thing to remember is that the entries already made must be reversed by further entries. In the case of a Bill Payable, i.e., a bill given to a creditor in payment of his account, the Bills Payable Account will have been credited and the personal account of the creditor debited with the amount of the bill. If, when the bill matures, i.e., becomes due, it has to be dishonoured owing to financial embarrassment, the entries necessary to record the dishonour will be to debit Bills Payable Account and credit the personal account of the creditor. If the creditor has incurred any expense through the bill being dishonoured, e.g., noting charges, he will naturally expect to be compensated by the debtor. His account then will be credited with the amount of the charges and a Charges Account debited. These entries will be made through the journal, the only entry in the bill book being a note in the last column to the effect that the bill has been dishonoured.

EXAMPLE.

On 1st January, A. Brown purchases goods from S. Smith for £200, giving in settlement a three months' bill. When the bill is presented for payment at maturity Brown is unable to pay it, and Smith has the bill noted, the charge being 3s. 6d. Show the entries in Brown's Ledger recording the transactions.

Dr. S. SMITH. Cr

19..		£ s. d.	19..			£ s. d.
Jan. 1	To Bills Payable .	200 0 0	Jan. 1	By Purchases* .		200 0 0
			April 4	By Bills Payable Dishonoured .		200 0 0
			„ 4	„ Notarial Charges		3 6

* The corresponding debit is included in the periodical posting to Purchases Account.

Dr. BILLS PAYABLE. Cr

19..		£ s. d.	19..		£ s. d.
April 4	To S. Smith; Dishonoured Bill	200 0 0	Jan. 1	By S. Smith . .	200 0 0

Dr. NOTARIAL CHARGES. Cr.

19..		£ s. d.			
April 4	To S. Smith . .	3 6			

In the case of a Bill Receivable, i.e., a bill received in settlement of a debt, the bill may have been retained until maturity when it was presented to the debtor for payment, or it may have been discounted with a banker. If it has been retained, the entries made in the books will have been to debit Bills Receivable Account and credit the personal account of the debtor. When the bill is dishonoured, the entries necessary to reverse these will be to credit Bills Receivable Account and debit the personal account of the debtor. If any expenses have been incurred the Cash Book will have been credited with the amount paid, and this should be posted to the debit of the personal account of the debtor, since he will be required to refund this amount.

EXAMPLE.

On 1st January, S. Smith sells, to A. Brown, goods to the value of £200, receiving in payment a three months' bill. The bill is dishonoured at maturity and is noted, the notarial charges being 3s. 6d. Show the entries in Smith's Ledger and Cash Book recording the transactions.

Dr. A. BROWN. Cr.

19..		£ s. d.	19..		£ s. d.
Jan. 1	To Sales* . .	200 0 0	Jan. 1	By Bills Receivable	200 0 0
April 4	To Bills Receivable Dishonoured .	200 0 0			
„ 4	„ Cash, Notarial Charges	3 6			

* The corresponding credit is included in the periodical posting to Sales Account.

Dr. BILLS RECEIVABLE. *Cr.*

19..			£ s. d.	19..			£ s. d.
Jan. 1	To A. Brown .		200 0 0	April 4	By A. Brown; Dishonoured Bill		200 0 0

Dr. CASH BOOK. *Cr.*

				19..			£ s. d.
				April 4	By A. Brown, Notarial Charges .		3 6

In the second case, where the bill has been discounted with the bank, the following entries will have been made in the books :—

(*a*) On receipt of the bill, Bills Receivable Account will have been debited and the personal account of the debtor credited with the amount of the bill.

(*b*) When the bill was discounted with the bank, the total of the bill will have been entered in the debit bank column of the Cash Book and posted to the credit of Bills Receivable Account, whilst the charges for discounting the bill will have been entered in the credit bank column in the Cash Book and posted to the debit of Banker's Discount Account.

When the bill is dishonoured any expenses incurred should be credited to the Cash Book and debited to the personal account of the debtor, as these expenses arose through his action in refusing payment of the bill. The latter account should also be debited with the face value of the bill, the bank column of the Cash Book being credited. No further entry will be necessary in respect of the discount charged by the bank, since this charge was made for the loan of the value of the bill by the bank for the period from the date of discounting to the date of maturity.

EXAMPLE.

On 1st January, S. Smith sold to A. Brown goods to the value of £200, receiving in settlement a three months' bill. On 1st February, the bill was discounted with the bank for £198 10s. On 5th April, the bill was returned unpaid, notarial charges being 3s. 6d. Show the entries in S. Smith's Ledger and Cash Book recording the transactions.

Dr. A. BROWN. *Cr.*

19..			£ s. d.	19..			£ s. d.
Jan. 1	To Sales * . .		200 0 0	Jan. 1	By Bills Receivable		200 0 0
April 5	To Bank; Dishonoured Bill .		200 0 0				
„ 5	„ Bank; Notarial Charges .		3 6				

* The corresponding credit is included in the periodical posting to Sales Account.

Dr. BILLS RECEIVABLE ACCOUNT. Cr.

			£ s. d.				£ s. d.
19.. Jan. 1	To A. Brown .		200 0 0	19.. Feb. 1	By Bank .		200 0 0

Dr. CASH BOOK (BANK COLUMN). Cr.

			£ s. d.				£ s. d.
19.. Feb. 1	To Bills Receivable Discounted .		200 0 0	19.. Feb. 1	By Banker's Discount . .		1 10 0
				April 5	„ A. Brown; Dishonoured Bill		200 0 0
				„ 5	„ A. Brown; Notarial Charges		3 6

Dr. BANKER'S DISCOUNT ACCOUNT. Cr.

			£ s. d.				
19.. Feb. 1	To Bank; Discount of Bill . .		1 10 0				

The steps to be taken when a bill has been dishonoured, will depend upon circumstances: usually the debtor's lack of funds is merely temporary, and the creditor agrees to accept a new bill for the full amount plus expenses and interest for the extended period; or, in the case of a part payment, for the balance remaining due. If, however, it appears useless to extend the period, then other steps must be taken for the recovery of the amount due.

Upon renewal of a bill, the debtor is debited with interest and the cost of new bill stamps, while the old bill is surrendered in exchange for the new acceptance. The latter is entered in the Bills Receivable Book in the usual manner.

EXAMPLE.

Goods are sold to A. Mann on 25th January for £240 on credit terms for a three months' bill from 1st February. The bill is accepted in due course and is discounted with the bank on 3rd February at $4\frac{1}{2}\%$ per annum. It is returned unpaid on 5th May, notarial charges being 3s. 6d.

On 10th May, A. Mann pays £100 on account and it is arranged that a new bill at three months' date shall be given for the balance plus interest at 6% per annum on amounts outstanding from 4th May. Show the entries in the seller's Ledger and Cash Book.

Dr. A. MANN'S ACCOUNT. *Cr.*

Date			£ s. d.	Date			£ s. d.
19..				19..			
Jan. 25	To Sales *		240 0 0	Feb. 1	By Bills Receivable		240 0 0
May 5	To Bank; Bill Dishonoured		240 0 0	May 10	By Bank		100 0 0
„ 5	„ Bank; Notarial Charges		3 6	„ 10	„ Bill Receivable		142 14 0
„ 10	„ Interest on Renewal of Bill		2 8 6				
„ 10	„ Bank; Bill Stamp		2 0				
			£242 14 0				£242 14 0

* The corresponding credit is included in the periodical posting to Sales Account.

Dr. BILLS RECEIVABLE ACCOUNT. *Cr.*

Date			£ s. d.	Date			£ s. d.
19..				19..			
Feb. 1	To A. Mann		240 0 0	Feb. 3	By Bank		240 0 0
May 10	To A. Mann		142 14 0				

Dr. CASH BOOK (BANK COLUMN). *Cr.*

Date			£ s. d.	Date			£ s. d.
19..				19..			
Feb. 3	To Bill Receivable No..., A. Mann		240 0 0	Feb. 3	By Discount Charges on A. Mann's bill, 90 d/s. on £240 @ 4½ %		2 13 3
May 10	„ A. Mann		100 0 0	May 5	„ A. Mann; Dishonoured Bill		240 0 0
				„ 5	„ A. Mann; Notarial Charges		3 6
				„ 10	„ A. Mann; Bill Stamp		2 0

Dr. BANKER'S DISCOUNT ACCOUNT. *Cr.*

Date			£ s. d.	Date			£ s. d.
19..				19..			
Feb. 3	To Bank		2 13 3				

Dr. INTEREST ACCOUNT. *Cr.*

Date			£ s. d.	Date			£ s. d.
19..				19..			
				May 10	By A. Mann		2 8 6

NOTE.—The interest payable by A. Mann, £2 8s. 6d., is obtained by charging 6% p.a. on £240 for 6 days, plus 6% p.a. on £140 for 95 days.

Bills Receivable Ledger.

Where bill transactions are very numerous, a combined Bills Receivable Journal and Ledger may be adopted ; it is usually termed the "Bills Receivable Ledger." A specimen of this ledger is shown on page 158, and by this method a separate page is used for the bills falling due each month.

The individual items are credited to the debtors' personal accounts in the usual way, while each page of the ledger is cleared at the end of the month by the cash received, plus discount charges and renewals (if any). The monthly total of the discount column is debited to the Bankers' Discount (or the Interest) Account in the General Ledger, each cash entry being cross referenced with the Cash Book folio.

Where this form of Bills Receivable Ledger is adopted, it is usually the practice to discount promptly all the bills received, and, therefore, at the end of the financial year there are usually very few bills in hand. At the end of the financial year the money columns of those pages which are not cleared are totalled, and the balance carried down is inserted in the "Renewals, etc.," column. The bills in hand are then re-entered on the lines below the totals.

If the bills payable are very numerous a similar ledger may be adopted to record these transactions. It will be obvious that, at the close of the trading period, the bills payable outstanding will appear on the pages representing future months, and to ascertain the total bills payable outstanding, all that is necessary is to add up these respective pages. If the end of the trading period occurs in the middle of a month, a balance for that month must be struck and brought down in the usual manner.

It will be observed that the Bills Receivable and Bills Payable Ledgers act as a diary, showing at a glance the bills falling due at any date. Where these books are adopted, it must be remembered that their respective balances must be inserted in the trial balance.

Accommodation Bills.

The nature of this class of bills has been explained on page 139, and although they are not often met with in modern business practice, accounting problems relating to these transactions are occasionally set at examinations. As a general rule, this class of question is best dealt with by means of journal entries (cash also being journalised), the narration in the journal assisting to explain the entry. This method has been adopted in the following typical example :—

EXAMPLE.

Jones, for the mutual and temporary accommodation of himself and Brown, draws upon the latter a bill of exchange at three months for £600, dated 1st March. Jones discounts this bill immediately at his bankers, the rate of discount being 5%, and hands half the proceeds to Brown.

Brown, for a similar purpose, and at the same time, draws a bill at three

BILLS RECEIVABLE LEDGER.

Date received.	From whom received.	Where payable.	Date of Bill.	Term.	Due date January 19..						Folio in Sales Ledger.	Amount of Bill.			How disposed of.	Date.	C.B. Fol.	Discount Charges.			Cash.			Renewals, etc.		
					1	2	3	4	5	etc. to 31st		£	s.	d.				£	s.	d.	£	s.	d.	£	s.	d.
19.. Oct. 3	J. Brown & Co.	Barclays, Hull	19.. Oct. 1	3 months				√			62	219	0	0	Discounted	19.. Oct. 11	101	2	11	0	216	9	0			
Oct. 6	B. Foster & Co.	Lloyds, St Albans	Oct. 2	3 months					√		66	240	0	0	Lodged with Bank	19.. Jan. 2	120				240	0	0			
											Total for month	£														

The combined total of these three columns will equal the total of the column "Amount of Bill."

Another form of this book shows the due dates in the following manner—

January	February	March	April	May	etc.
4					
5					

The due date of the above bills would be entered thus—

months on Jones for £300. This he discounts at his bankers at 5% and hands half the proceeds to Jones. Brown becomes a bankrupt on 30th May and a first and final dividend of 5s. in the £ is paid on his estate on 31st July.

Assume, in each case, that one-half of the charge for discounting the bill is chargeable to Brown and one-half to Jones.

Prepare journal entries recording these transactions in (*a*) Jones' books, (*b*) Brown's books. Also show Brown's account in Jones' books and Jones' account in Brown's books.

JONES' JOURNAL.

Date		Dr. £	s.	d.	Cr. £	s.	d.
19.. Mar. 1	Bills Receivable Account . *Dr.*	600	0	0			
	To Brown				600	0	0
	Being 3 months' accommodation bill accepted by Brown.						
" "	Cash . . . . . . *Dr.*	600	0	0			
	To Bills Receivable Account .				600	0	0
	Being Bill Receivable discounted.						
" "	Sundries . . . . . *Dr.*						
	To Cash				7	16	2
	Bank Charges	3	18	1			
	Brown	3	18	1			
	Being Banker's discount on bill shared equally with Brown, as arranged.						
" "	Brown . . . . . . *Dr.*	296	1	11			
	To Cash				296	1	11
	Being half proceeds of discounted bill paid to Brown.						
" "	Brown . . . . . . *Dr.*	300	0	0			
	To Bills Payable Account . .				300	0	0
	Being 3 months' bill drawn by Brown.						
" "	Cash . . . . . . *Dr.*	148	1	0			
	To Brown				148	1	0
	Being half proceeds of bill remitted by Brown						
" "	Bank Charges . . . . *Dr.*	1	19	1			
	To Brown				1	19	1
	Being half discounting charges on bill, as notified by Brown.						
June 4	Sundries . . . . . *Dr.*						
	To Cash				900	0	0
	Bills Payable Account . . .	300	0	0			
	Brown	600	0	0			
	Being discharge of bill for £300 drawn by Brown; and of the bill for £600 accepted by Brown on his default.						
July 31	Cash . . . . . . *Dr.*	112	10	0			
	To Brown				112	10	0
	Being dividend of 5s. in £ on amount due from Brown						
" "	Bad Debts Account . . . *Dr.*	337	9	11			
	To Brown				337	9	11
	Being irrecoverable balance on Brown's account written off.						

BROWN'S ACCOUNT.
(IN JONES' LEDGER.)

Dr. *Cr.*

19..			£ s. d.	19..			£ s. d.
Mar.	1	To Cash	3 18 1	Mar.	1	By Bill Receivable	600 0 0
"	"	" "	296 1 11	"	"	" Bank Charges	1 19 1
"	"	" Bill Payable	300 0 0	"	"	" Cash	148 1 0
June	4	" Bill Receivable dishonoured	600 0 0	July	31	" "	112 10 0
				"	"	" Bad Debts	337 9 11
			£1,200 0 0				£1,200 0 0

BROWN'S JOURNAL.

19..			Dr. £ s. d.	Cr. £ s. d.
Mar.	1	Jones . . . . . . Dr.	600 0 0	
		To Bills Payable Account		600 0 0
		Being accommodation bill drawn by Jones and accepted this day.		
"	"	Sundries . . . . . Dr.		
		To Jones		300 0 0
		Bank Charges	3 18 1	
		Cash	296 1 11	
		Being receipt of half the proceeds of bill drawn by Jones.		
"	"	Bills Receivable Account . Dr.	300 0 0	
		To Jones		300 0 0
		Being accommodation bill accepted by Jones.		
"	"	Cash . . . . . . Dr.	300 0 0	
		To Bills Receivable Account		300 0 0
		Being bill discounted this day.		
"	"	Sundries . . . . . Dr.		
		To Cash		3 18 1
		Bank Charges	1 19 0	
		Jones	1 19 1	
		Being bank charges on bill discounted, shared equally with Jones as arranged.		
"	"	Jones . . . . . . Dr.	148 1 0	
		To Cash		148 1 0
		Being payment of half proceeds of bill, as arranged.		
June	4	Bills Payable Account . . Dr.	600 0 0	
		To Jones		600 0 0
		Being dishonoured bill payable, discharged by Jones.		
July	31	Jones . . . . . . Dr.	449 19 11	
		To Sundries		
		" Cash		112 10 0
		" Deficiency Account		337 9 11
		Being final discharge of debt due to Jones by payment of dividend of 5s. in £.		

JONES' ACCOUNT.

Dr. (In Brown's Ledger.) Cr.

19..		£ s. d.	19..		£ s. d.
Mar. 1	To Bill Payable .	600 0 0	Mar. 1	By Bank Charges	3 18 1
" "	" Bank Charges	1 19 1	" "	" Cash . .	296 1 11
" "	" Cash . .	148 1 0	" "	" Bill Receivable	300 0 0
July 31	" " . .	112 10 0	June 4	" Bill Payable Dishonoured	600 0 0
" "	" Deficiency A/c.	337 9 11			
		£1,200 0 0			£1,200 0 0

EXERCISE 5.

A. Define and state the characteristics of a negotiable instrument. What instruments are recognised as negotiable by English law ?

B. Define and compare a "bill of exchange" and a "promissory note."

C. Define an "inland" bill of exchange. In what respects is the distinction between an inland bill and a foreign bill of any importance ?

D. Enumerate the essentials to validity in a bill of exchange. Give an example.

E. Define "acceptance" of a bill of exchange and state the requisites of a valid acceptance. What is the effect of an acceptance to pay at a particular place ? What are the liabilities of an acceptor for honour ?

F. Explain the meaning and use of the phrase "Referee in Case of Need."

G. (*a*) Draft a form of an inland bill.
(*b*) Draft a form of a foreign bill.

H. What is an accommodation bill of exchange ?

I. State briefly the obligations of the following parties to a bill of exchange :—
(*a*) The acceptor. (*b*) The drawer. (*c*) The indorser.

J. Explain the difference between a general and a qualified acceptance of a bill of exchange. Illustrate your answer by giving an example of each.

K. What is the best and simplest way of dealing with bills receivable and bills payable in the books of a business in which bill transactions are numerous ?

L. Draw up a form for a Bills Receivable Book and enter therein three examples. State how the double entry principle in book-keeping is observed as regards the use of this book.

M. Draft what you consider the best form of a Bills Payable Book, making a few entries. How would you connect these with the other books of account ? What entries are made when a bill is retired ?

N. On 1st March H. Halsey buys from G. Vernon goods value £750. Instead of paying cash, Halsey agrees to give Vernon a bill of exchange at four months, the amount of the bill to include interest at 6% per annum. On the due date, Halsey is only able to find £415 in cash, and he arranges with Vernon for the retirement of the bill in consideration of this payment and a substituted bill at four months for the balance, plus interest at 6% per annum. Give the necessary entries in Vernon's books (Journal and Ledger). Days of grace may be ignored.

O. A customer of a business owes £100; he is allowed a discount of 2½% and is drawn upon for the balance by an acceptance at three months. The bill is dishonoured at maturity. Set out the entries necessary to be made in the books of the business to which the debt is due.

P. On 1st January *A* owes *B* £6,000 for which *B* receives two acceptances from *A*, one for £2,000 payable in two months, the other for £4,000 payable in four months, in each case from 1st January. *B* duly discounts both these acceptances with his bankers on 3rd January at 4%.

Before the first bill becomes due *A* requests *B* to assist him in taking it up by providing him with £1,000 in cash, and drawing a third bill on *A* for that amount at three months from the due date of the first bill plus interest at 5% per annum ; *B* agrees to this proposal and advances the money, discounting the bill with his bankers at 4%.

A week before the second bill for £4,000 falls due *A* again asks *B* to assist him to the extent of £2,500. *B*, however, is not in a position to do this, and, as his bankers will not discount any more of *A's* acceptances, he arranges with *A* to draw on him (*B*) two bills for £1,131 16s. 8d. and £1,408 3s 4d. at two months and three months respectively from the due date of the £4,000 bill. *B* duly accepts these two bills and remits them to *A*, who discounts them with his bankers at 4%, and, assisted by the proceeds, duly meets the £4,000 bill. *B* also meets his two bills on maturity. On 7th June, *A* becomes bankrupt, leaving his third bill unpaid. Make the necessary entries in *B's* books to give effect to the above transactions.

Q. A. Kight and B. Just, being in want of funds, on 7th January draw accommodation bills on each other, at four months, for £60. They discount the bills at 6% per annum and each meets his own acceptance at maturity. Show the ledger accounts in A. Kight's books.

R. On 31st January *A* owed *B* £500, for which *B* received two acceptances from *A*, one for £300, payable in two months, and one for £200, payable in four

months. Each bill was dated 1st February. *B* discounted both these acceptances with his bankers on 28th February at 4%.

Before the first bill became due *A* applied to *B* for assistance in meeting the bill by providing £200 in cash. This *B* agreed to, on condition that a new acceptance at two months was given for the amount advanced, plus 5%.

A week before the second bill was due *A* again applied to *B* for assistance, but *B* refused, and suggested that the bill should be renewed at two months, plus 5%. This was done, and the bill due 7th June was duly met, but on 15th June *A* became bankrupt, leaving one bill, not yet due, unpaid. On 31st August his trustee paid a first and final dividend of 12s. 6d. in the £.

Make the entries in *B's* books necessary to record the above transactions.

S. Set out a form of ruling of a "Bills Receivable Book" which will serve also as the ledger account of bills receivable, and enter therein the following transactions, all the bills being drawn by "selves" on the persons from whom received:—

19..			£	s.	d.
July	9.	Received bill from G. Jackson, dated 6th July, payable three months after date	200	0	0
„	17.	Received bill from B. Sidwell, dated 15th July, payable six months after date	187	4	2
„	18.	Discounted G. Jackson's draft with own bankers	197	15	0
Aug.	21.	Received bill from P. Mathew, dated 19th August, payable three months after date	492	7	6
Sept.	13.	Received bill from B. Meyer, dated 10th September, payable three months after date	117	2	11
Oct.	10.	Discounted Meyer's draft with own bankers	116	0	6
Nov.	7.	Received bill from H. Longton, dated 7th November, payable six months after date	328	4	0
„	22.	Received cash, P. Mathew's bill	492	7	6
„	22.	Received cash from Longton to retire his bill	319	2	4
Dec.	18.	Received bill from O. Nunn, dated 12th December, accepted 17th December, payable three months after sight	240	0	0

Bring down the balance on the book on 31st December.

T. On 1st January, 19.., *A* drew and *B* accepted a bill at three months for £1000. On 4th January *A* discounted the bill at 6 per cent. per annum, and remitted half the proceeds to *B*. On 1st February, 19.., *B* drew and *A* accepted a bill at three months for £400. On 4th February, *B* discounted the bill at 6 per cent. per annum, and remitted half the proceeds to *A*. *A* and *B* agreed to share the discounts equally.

At maturity *A* met his acceptance but *B* failed to meet his, and recourse was had to *A*; *A* drew and *B* accepted a new bill at three months for the amount of the original bill plus interest at 5 per cent. per annum.

On 1st July, 19.., *B* became bankrupt. A first and final dividend of 10s. 0d. in the £ was paid by his trustee in bankruptcy on 31st October, 19...

Write up *B's* Account in *A's* books. Make calculations in months.

CHAPTER VI

THE ACCOUNTS OF PARTNERS

BEFORE dealing with the entries required to record partnership transactions in the books of account, it will be necessary to consider :—

(1) What constitutes a partnership ;
(2) The relations of the partners with each other and with the general public ; and
(3) The rules and regulations governing these relationships.

In the absence of any agreement, ordinary partnerships are governed by the rules laid down in the Partnership Act, 1890, and limited partnerships by the Limited Partnership Act, 1907.

Definition of a Partnership.

Partnership is defined by Section 1 of the Partnership Act, 1890, as "the relation which subsists between persons carrying on a business in common with a view of profit." Sir Frederick Pollock has defined partnership more fully as "The relation which subsists between persons who have agreed to share the profits of a business, carried on by all or any of them for the benefit of all of them." Section 2 of the Act states that in determining whether a partnership does or does not exist, regard shall be had to the following rules :—

(1) Joint tenancy, tenancy in common, joint property, common property, or part ownership does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof.
(2) The sharing of gross returns does not of itself create a partnership, whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived.
(3) The receipt by a person of a share of the profits of a business is *primâ facie* evidence that he is a partner in the business, but the receipt of such a share, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business.

The following, however, do not of themselves make a person a partner or liable as such :—

(i) The receipt by a person of a debt out of accruing profits.
(ii) The receipt by a servant or agent of a share of the profits of a business.
(iii) The receipt by the widow or child of a deceased partner of an annuity payable out of the profits.

(iv) The advance of money by way of loan, on a contract that the lender shall receive a rate of interest varying with the profits arising from carrying on the business, provided that the contract is in writing, and signed by or on behalf of all the parties thereto. (The object of the contract in writing is to afford proof that no partnership exists.)

(v) The receipt of an annuity or a portion of the profits of a business, in consideration of the sale of the goodwill of the business.

In cases (iv) and (v) the persons concerned, although not partners, are deferred creditors, i.e., in the event of the bankruptcy of the borrower (or the purchaser as the case may be) their claims will not be paid until all other creditors entitled to prove in the bankruptcy have been paid in full. If the agreement mentioned in (iv) is not in writing the lender may be held liable as a partner.

What Constitutes a Partnership.

In dealing with partnership matters the definitions of a partnership, as given above, should be kept in mind. From these it will be observed that there are three essentials which must exist in order to constitute a partnership. These are :—

(1) There must be a *business*, and for this purpose "business" means any trade, occupation, or profession.

(2) It must be carried on *in common*—i.e., it must be carried on by some or all of them for the benefit of all of them.

(3) It must be *with a view to profit ;* therefore the members of a club, which is not carried on for the purpose of making profits, are not partners.

If these three essentials are kept in mind, it will in most cases be easy to ascertain whether or not two or more persons are partners.

Subject to the five exceptions given above, the sharing in the profits of the partnership business is very strong evidence of the existence of a partnership, and unless it is rebutted, gives rise to a presumption that a partnership in fact exists. The doctrine that the sole test of partnership was participation in profits was destroyed by the judgment in *Cox* v. *Hickman*, 1860. It was decided there that the true test of partnership was not merely participation in profits, but participation in profits in such a way as to create a relation of agency between the participators.

Limitation of the Number of Partners.

A partnership may not in any case consist of more than twenty persons, and if the partnership carries on the business of banking it must not comprise more than ten persons. Any combination or association of persons for purposes of trading with a view to profit, which exceeds these specified numbers, is not a partnership, and must be registered as a company under the Companies Act, 1929.

The Partnership Name.

A partnership is sometimes termed a "firm," and the name by which it is known is called the "firm" name. In the case of partnerships having a place of business in the United Kingdom, the Registration of Business Names Act, 1916, provides that :—

(1) If the firm name does not consist of the true surnames of all partners who are individuals, and the corporate names of all partners who are corporations, without any addition except the true Christian names or initials of the individual partners ; and

(2) In cases where a partner has changed his name, except in the case of a woman who has married,

the firm must be registered under the provisions of the Act, and must file the following information with the Registrar of Business Names at the Board of Trade :—

(1) The business name, the general nature of the business, the principal place of business and the date of commencement of business.

(2) In respect of each individual partner, his present Christian name and surname, any former Christian name or surname, his nationality, and if that has been changed, his nationality of origin, his usual residence, and any other occupation.

(3) In the case of a corporation which is a partner, the corporate name and registered office.

(4) Any change in the constitution of the firm.

Kinds of Partners.

Partners are variously described according to the nature of their activities in connection with the partnership business, but for book-keeping purposes they fall into two main classes :—

A GENERAL PARTNER is one who has full powers of participating in the conduct of the partnership business, and who is liable to the full extent of his estate for the partnership debts.

A LIMITED PARTNER is one who has agreed to contribute a certain sum to, but is prevented by law from taking any part in the management of a partnership business, registered under the LIMITED PARTNERSHIP ACT, 1907, as a limited partnership. Unless the limited partner does take part in the management of the partnership business, he is liable for the debts of the partnership only up to the amount he has agreed to contribute to the partnership assets. In any limited partnership there must be one or more general partners who are liable, for the debts of the partnership business, to the full extent of their separate estates.

There are other sub-classifications of partners, e.g., " dormant " or " sleeping " partners, who take no part in the management, but have unlimited liability. For present purposes, however, the two main classifications into general partners and limited partners will be found sufficient.

Characteristics of a Partnership.

The leading characteristics of a partnership may be thus summarised :—

(1) Each general partner is liable jointly with the other partners for the whole of the partnership debts incurred while he is a partner. The estate of a deceased partner is jointly and severally liable. In Scotland the liability of a partner is joint and several. (Partnership Act, 1890, Section 9.) The difference between being "jointly" and "jointly and severally" liable is that in the former case there is only one cause of action, and therefore when once a plaintiff has sued one or some of the partners, and recovered judgement, he cannot bring a subsequent action against any of the others if the judgement remains unsatisfied ; whereas in the latter case a plaintiff may first obtain judgement against one or more of the partners and subsequently sue other partners, one or more at a time, and recover judgement against them, until all the partners have been sued, or the amount due has been paid.

(2) The liability of a limited partner is restricted to the amount he has agreed to contribute, unless he commits certain acts which render him fully liable as a general partner. (Limited Partnership Act, 1907, Section 4.)

(3) Every partner is an agent of the firm and of his co-partners for the purposes of the business of the partnership. (Partnership Act, 1890, Section 5.)

(4) Some or all of the partners contribute money, or its equivalent, for use in the partnership business ; the contributions of the several partners may vary in amount, and the sum contributed by each partner is termed his capital.

(5) The ultimate object of the partnership is the acquisition of profit or gain, although losses may, of course, result. These profits or losses are shared in such proportions as may be agreed ; e.g., equally, or in proportion to each partners' capital.

In the absence of agreement, Section 24 of the Partnership Act, 1890 (see below), provides that profits or losses must be shared equally.

(6) Each partner (other than a limited partner) is entitled to participate in the management of the partnership business, but, except where specially agreed, he is not entitled to remuneration for so acting.

Partnership Act, 1890, *Section* 24.—In the absence of any *express* or *implied* agreement between the partners relating to their interests in the partnership property, and their respective rights and duties, this section provides that the following rules shall apply :—

(1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses whether of capital or otherwise sustained by the firm

(2) The firm must indemnify every partner in respect of payments made and personal liabilities incurred by him—

(*a*) In the ordinary and proper conduct of the business of the firm; or

(*b*) In or about anything necessarily done for the preservation of the business or property of the firm.

(3) A partner making, for the purpose of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of 5% per annum from the date of the payment or advance.

(4) A partner is not entitled, before the ascertainment of profits, to interest on capital subscribed by him.

(5) Every partner may take part in the management of the partnership business.

(6) No partner shall be entitled to remuneration for acting in the partnership business.

(7) No person may be introduced as a partner without the consent of all existing partners.

(8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners.

(9) The partnership books are to be kept at the place of business of the partnership (or the principal place, if there is more than one), and every partner may, when he thinks fit, have access to and inspect and copy any of them.

Section 28 of the same Act provides that partners are bound to render true accounts and full information of all things affecting the partnership to any partner or to his legal representatives.

Articles of Partnership.

A firm may be established without any formality, and although the partners have certain unavoidable obligations to third parties, they may make such arrangements between themselves as to the internal management of the firm and its financial affairs as they may choose.

These arrangements may be expressed in writing, or be made orally, or they may be implied from the conduct of the partners ; e.g., if one partner regularly draws a monthly salary of £50 with

the knowledge of the other partners, it is assumed that this partner is entitled to the salary by mutual agreement.

But while formally expressed rules and regulations are not legally necessary, it is most desirable that, in the event of a dispute arising during the course of the partnership or on dissolution by death or retirement, there should be available a definite statement of the terms of agreement between the partners.

In addition, many of the regulations of the Partnership Act, 1890, although perfectly just and equitable, may be found unsuitable for the circumstances of the partnership, and it is highly advisable that the agreement excluding the provisions of the Act should be clearly set out in writing, as in the absence of an agreement, express or implied, the Act applies.

It is accordingly usual for persons entering into partnership to express their intentions in "Articles of Partnership." This document, which may be either written or executed under seal, contains provisions upon such matters and of such a nature as the partners and their legal advisers may deem expedient, having regard to the particular circumstances in each case. Most partnership agreements deal with the following points, *inter alia*:—

(1) The rights and duties of each partner.

(2) The amount of each partner's initial contribution to the capital of the firm.

(3) The division of profits and losses.

(4) The limit of each partner's drawings in anticipation of profits.

(5) The salaries (if any) to be paid to the partners.

(6) The rate of interest (if any) to be allowed on capital.

(7) The rate of interest (if any) to be charged on partners' drawings.

(8) That a record of the partnership transactions be entered in books of account to be kept at a specified place, and to be open to the inspection of any partner or his approved representative.

(9) That annual Trading and Profit and Loss Accounts and a Balance Sheet shall be prepared, audited by professional accountants and signed by all the partners.

(10) That the audited and signed accounts shall be accepted as final by the partners, and be reopened only if a manifest error is discovered within a stated period.

(11) The basis of valuing goodwill on the death or retirement of a partner.

(12) The method of determining the amount to be paid to a retiring partner or to the legal representative of a deceased partner, in respect of capital and profits since the date of the last agreed accounts.

(13) The circumstances which shall dissolve the partnership, the notice to be given by a retiring partner, etc.

(14) The right of one or more partners to introduce a new partner without the consent of all.

(15) An arbitration clause, providing for submission to an arbitrator of any dispute which arises.

Dissolution of Partnership.

A partnership is automatically dissolved by the happening of any event which makes it unlawful to carry on the business, or for the members to carry it on in partnership.

Subject to agreement a partnership is dissolved—

(1) If entered into for a fixed term, by the expiration of that term.

(2) If entered into for a single adventure or undertaking, by its termination.

(3) If entered into for an undefined time, by any partner giving notice to the others of his intention to dissolve the partnership.

(4) By the death or bankruptcy of a partner.

The Court also may decree dissolution in certain cases on the application of a partner. (See Chapter XV.)

Partnership Accounts.

The chief financial arrangements between partners fall under the following headings :—

(1) CAPITAL.—Capital may be introduced by some or all of the partners, and may consist of cash paid into the firm's banking account, or the introduction of some asset or assets other than cash ; e.g., a partnership may be entered into by a sole trader and another person, the former introducing a miscellaneous collection of assets representing his existing business, which, after deducting any existing liabilities, would represent the amount of his capital in the firm, and the latter contributing a sum of money as his share of the capital. The capital contributed by each partner is debited to the appropriate asset account, or to bank, and credited to the Capital Account of the partner. Unless there is an agreement to the contrary, the ratio in which capital is contributed may bear no relation to the proportion in which profits and losses are to be shared.

Partners' Capital and Current Accounts.—The capital of a firm is not recorded in a single account, as in the case of a sole trader; a separate capital account is opened in the name of each partner. Each capital account is credited with the amount of capital contributed by that partner on the formation of the partnership or subsequently introduced; with interest on his capital (if allowed); and with his share of the profits.

The accounts are debited with the respective partners' drawings, interest thereon (if charged), and with his share of the loss on trading, if any.

Each partner's account is closed after the preparation of the periodical Profit and Loss Account, and the balance brought down, if a credit, represents the partner's capital as at the beginning of the new period; while a debit balance indicates a deficiency, i.e., that more than the partner's capital has been absorbed by drawings and/or by his share of losses on trading.

Where the Articles of Partnership provide that the partners' capitals shall be maintained at stated amounts, it is usual to enter in the respective capital accounts only the actual contributions to capital, and to record the drawings, shares of profits or losses, and interest on capital and drawings, in current accounts, one of which is opened for each partner. This method is supported by the leading authorities and should be adopted for examination purposes unless the question indicates that current accounts are not kept. Where the capitals are odd amounts (e.g., £2,504 15s. 3d.), it may usually be assumed that current accounts are not used. Current accounts should always be opened in the case of a limited partner, in order to indicate whether he has withdrawn part of his agreed capital.

When a partner's current account shows a credit balance, after profits, drawings, etc., for the year have been included, he may, subject to any special arrangement to the contrary, draw a further amount equal to the balance. But if a debit balance results, e.g., through excessive drawings or the failure of the profits to reach expectations, he may be required to repay the amount overdrawn, or to clear off the debit balance by reducing his drawings during the period next ensuing.

Interest on Capital.—Apart from express or implied agreement, partners are not entitled to interest on their capital accounts, but where the respective partners' capitals are unequal in amount, it is usual for them to agree that each partner shall be credited annually with interest at a fixed rate on the amount of his capital, as at the beginning of the year. This practice is adopted in order to adjust the rights of the partners *inter se*; the annual amount charged by way of interest represents the income which would be yielded by the respective partners' capitals if invested outside

the firm's business. Such interest is debited in the Profit and Loss Appropriation Account, the respective partners' accounts being credited.

(2) LOANS.—Where any partner introduces cash by way of a loan to the firm, this must be credited, *not* to his capital account, but to a special loan account, where it will remain as a liability until repaid.

Subject to special agreement to the contrary, interest at 5 per cent. per annum is payable on loans from partners as distinct from capital. This loan interest is credited to the special loan account or to the partner's capital or current account, and debited to interest account, being eventually transferred therefrom to the Profit and Loss Account as an expense. The amount of any undrawn loan interest should be kept distinct from undrawn interest on capital, and should be shown separately on the Balance Sheet. The importance of distinguishing between capital and a loan lies in the fact that on dissolution, when there may be a deficiency of assets, loans, together with any interest due thereon, are repayable before amounts due on capital and current accounts.

(3) PARTNERS' SALARIES.—The Articles of Partnership may provide that one or more of the partners shall receive a fixed salary in addition to a share in the profits. This provision is usually found when there is a senior partner drawing the bulk of the profits and one or more junior partners, to whom a fixed salary assures a minimum income. Salaries are also a convenient means of adjusting the distribution of profits where some partners are active and others dormant, or where one or more partners devote only part of their time to the affairs of the firm. Such salaries are recorded in the books by crediting cash, or the partner's current account if not paid in cash, and debiting a Partners' Salary Account; the total of the latter account being eventually transferred to the Profit and Loss Appropriation Account.

(4) DRAWINGS.—Where no salaries are provided for, it is customary for the partners to be permitted to withdraw, at fixed or irregular intervals, sums on account of the share of profits to which they expect to be entitled at the end of the financial year. Drawings, therefore, are not a charge against profits, and must not be transferred to Profit and Loss Account.

The sums drawn are credited in the cash book and debited to the respective partner's capital or current account. Drawings are authorised by express or implied agreement of the partners; usually a maximum amount per annum for each partner is fixed by the Articles of Partnership.

Interest on Drawings.—This is generally ignored unless very

large amounts are involved, but when the partnership agreement provides for interest on drawings, the amount relating to each partner is calculated and credited in the Profit and Loss Appropriation Account, the respective partners' current accounts being debited. The interest is calculated on each separate drawing from the date thereof to the end of the financial period or, alternatively, the average due date method described in Chapter X can be adopted.

Limited Partnerships.

Owing to the passing of the Companies Act, 1907, which has now been incorporated in the Companies Act, 1929, and the subsequent popularity of the Private Limited Company, with a minimum membership of two, the provisions of the Limited Partnership Act have not been utilised to a very great extent.

A LIMITED PARTNERSHIP is one formed and registered under the Limited Partnership Act, 1907, having one or more general partners liable for all the debts and obligations of the firm, and one or more limited partners, who at the time of entering into the partnership contribute thereto as capital a sum or sums of money or property valued at a stated amount, and who are not liable for the debts or obligations of the firm beyond the amount so contributed. A limited partner may not, during the existence of the partnership, draw out or receive back any part of his contribution. If he does so he is liable for the debts and obligations of the firm up to the amount withdrawn.

Limited Partnerships, which must not consist of more than ten persons in the case of banking concerns, nor more than twenty persons in other concerns, must be registered with the Registrar of Companies. Any change in the constitution of the firm has to be notified to the Registrar.

Registration is carried out by filling up and forwarding to the Registrar the necessary forms, and by payment of the Registration Fee and an *ad valorem* stamp duty of 10s. per £100 on the amount of capital introduced by the limited partner. On completion of registration, a certificate is issued to the firm.

The public have the same right of inspection of the register as they have in the case of a Limited Company.

A limited partner may not take part in the management of the firm ; and if he does so, he becomes liable as a general partner for all debts and obligations of the firm incurred while he so takes part in the management. He cannot bind the firm, but he can require accounts, inspect the books, either personally or by his agent, and advise in the management of the business.

With the consent of the general partners, a limited partner may assign his share in the partnership, and upon such assignment, the assignee becomes a limited partner with all the rights of the assignor.

Neither the death, bankruptcy nor lunacy of a limited partner dissolves the partnership. In the event of dissolution, limited partnerships are wound up by the general partners.

Limited partnerships may give rise to a number of peculiar book-keeping problems, which are dealt with later in this chapter (see page 208).

Profits and Losses in Partnership.

It will be remembered that in a sole trader's accounts the final balance of the Profit and Loss Account is transferred direct to the trader's Capital Account, but with partnership Profit and Loss Accounts, it is better to transfer the net profit to an Appropriation Account, which is really a continuation of the Profit and Loss Account, and shows the net result of trading prior to the adjustment of the rights of the partners *inter se*. This account is credited with net profit (or debited with the net loss); credited with interest on drawings, if any; and debited with partners' salaries and interest on capital. The balance represents the net profit (or loss), and is shown divided into the shares to be credited, if a profit, or debited, if a loss, to the accounts of the respective partners.

EXAMPLE

James Elliott and William Goode are in partnership, trading as Elliott & Co. On 1st January, Elliott had £2,000 capital and Goode £1,000; their drawings for the year amounted to £600 and £400 respectively. The net trading profit for the year amounted to £1,800, and, after charging interest on capital at 5% per annum, the partners share profits equally. No interest is chargeable on drawings. Show the Profit and Loss Appropriation Account and the partners' Capital Accounts. Separate Current Accounts are not used.

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT. *Cr.*

			£	£				£
19..					19..			
Dec. 31	To Interest on Capital—				Dec. 31	By Net Profit from Profit and Loss Account . .		1,800
	J. Elliott .		100					
	W. Goode .		50					
				150				
„ 31	„ Balance—							
	J. Elliott (½) .		825					
	W. Goode (½) .		825					
				1,650				
				£1,800				£1,800

J. ELLIOTT.

Dr. CAPITAL ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 31	To Cash, Drawings .		600	Jan. 1	By Balance . .	*b/f.*	2,000
„ 31	„ Balance .	*c/d.*	2,325	Dec. 31	„ Interest on Capital		100
				„ 31	„ Profit and Loss Appropriation Account, Share of Profit . .		825
			£2,925				£2,925
				19..			
				Jan. 1	By Balance . .	*b/d.*	2,325

W. GOODE.

Dr. CAPITAL ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 31	To Cash, Drawings .		400	Jan. 1	By Balance . .	*b/f.*	1,000
„ 31	„ Balance . .	*c/d.*	1,475	Dec. 31	„ Interest on Capital		50
				„ 31	„ Profit and Loss Appropriation Account, Share of Profit . .		825
			£1,875				£1,875
				19..			
				Jan. 1	By Balance . .	*b/d.*	1,475

If the example had stated that Current Accounts were used by Elliott and Goode, the entries therein would have been shown thus :—

J. ELLIOTT.

Dr. CURRENT ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 31	To Cash, Drawings		600	Dec. 31	By Interest on Capital .		100
„ 31	„ Balance . .	*c/d.*	325	„ 31	„ Profit and Loss Appropriation Account, Share of Profit .		825
			£925				£925
				19..			
				Jan. 1	By Balance . .	*b/d.*	325

W. GOODE.

Dr. CURRENT ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 31	To Cash, Drawings		400	Dec. 31	By Interest on Capital .		50
„ 31	„ Balance . .	*c/d.*	475	„ 31	„ Profit and Loss Appropriation Account, Share of Profit .		825
			£875				£875
				19.. Jan. 1	By Balance . .	*b/d.*	475

Capital Accounts would have been opened for J. Elliott and W. Goode, and on these would appear credit balances of £2,000 and £1,000 respectively.

Unless the agreement provides to the contrary, full provision should be made for interest on partners' capitals and partners' salaries, although the effect of such provisions may be to convert a net profit into a "divisible" loss or to increase the amount of a net loss. Such adjustments are essential in order to maintain the equitable rights of partners *inter se.*

EXAMPLE.

Messrs. Hod and Watt are in partnership with capitals of £5,000 and £1,000 respectively. They agree to allow interest on capitals at 5 per cent. per annum, and to share profits and losses equally. The profits for the year before charging their interest on capitals are £100. Show the Profit and Loss Appropriation Account.

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *Cr.*

			£				£
	To Interest on Capitals—				By Net Profit from Profit and Loss Account .		100
	Hod: 5% on £5,000 .		250		„ Share of Net Loss:		
	Watt: 5% on £1,000 .		50		Hod (½) .		100
					Watt (½)		100
			£300				£300

NOTE.—If the provision for interest on capitals was ignored both partners would be credited with £50 (i.e., one-half of the net profit of £100), thus Hod would be penalised to the extent of £100 (i.e., £250—£100—£50) while Watt would benefit to the extent of £100 (i.e., £50—£100—£50).

Interest on Drawings.

As previously stated, partnership deeds sometimes provide that interest shall be charged on partners' drawings as well as

allowed on their capitals. In such cases the interest is calculated at the close of each financial period according to the ordinary rules of arithmetic.

Where the drawings take place at irregular intervals, the interest must be calculated on the number of days which elapse between the date of the payment and the closing date of the financial year. But if the withdrawals are made regularly on, say, the last day of each calendar month, the interest may be more conveniently calculated on the number of months between the dates of payment and the end of the financial year, as in the following example :—

EXAMPLE.

Messrs. Percy & Saunders are in partnership and share profits and losses as to Percy three-sevenths and Saunders four-sevenths. Under the partnership deed they are entitled to 5% interest on capital, and are charged 6% interest on drawings. Their drawings during the year ended 31st December were as follows: Percy, £50 on 31st January, £60 on 31st March, and £40 on 31st July; Saunders, £100 on 31st March, £60 on 30th June, and £70 on 31st August. The capitals of the partners at the beginning of the year were as follows:—Percy, £1,500; Saunders, £2,000.

The profit, after taking into consideration the above adjustments, amounted to £1,400.

Show the partners' Current Accounts as on 31st December. (*See page* 178.)

Adjustment of Closed Partnership Accounts.

After a firm's accounts have been closed, it is sometimes found that an error or omission necessitates further entries to correct the division of the profits as between the partners.

Such adjustments are most frequently required through the shares of profits being ascertained and credited to the partners' accounts before interest on capital and/or drawings has been brought into account, or through the profits being divided in incorrect proportions.

The adjustments involve no new principle and are referred to only because questions involving them are frequently set by examiners.

EXAMPLE.

After including the profits for the year ended 30th June, and dealing with drawings, the capital accounts of Brown, Jones, and Robinson stood at £4,000, £3,000, and £2,000 respectively.

Subsequently they ascertained that interest on capital at 5% and interest on drawings had been omitted, the latter sums being Brown, £25; Jones, £18; and Robinson, £10. The profits for the year in arriving at the above figures of capital amounted to £6,000 and their drawings had been: Brown, £1,000; Jones, £750; and Robinson, £450. They shared profits and losses as to Brown

Dr. PERCY'S CURRENT ACCOUNT. **Cr.**

Date	Particulars	Months	Interest £ s. d.	£ s. d.	Date	Particulars	£ s. d.
19..					19..		
Jan. 31	To Cash, Drawings	11	2 15 0	50 0 0	Dec. 31	By Interest on Capital	75 0 0
Mar. 31	„ Do. Do.	9	2 14 0	60 0 0	„ „	„ Share of Profit	600 0 0
July 31	„ Do. Do.	5	1 0 0	40 0 0			
Dec. 31	„ Interest on Drawings	..		6 9 0			
„ „	„ Balance *c/d.*	..	..	518 11 0			
				£675 0 0			£675 0 0
					19..		
					Jan. 1	By Balance *b/d.*	518 11 0

Dr. SAUNDERS' CURRENT ACCOUNT. **Cr.**

Date	Particulars	Months	Interest £ s. d.	£ s. d.	Date	Particulars	£ s. d.
19..					19..		
Mar. 31	To Cash, Drawings	9	4 10 0	100 0 0	Dec. 31	By Interest on Capital	100 0 0
June 30	„ Do. Do.	6	1 16 0	60 0 0	„ „	„ Share of Profit	800 0 0
Aug. 31	„ Do. Do.	4	1 8 0	70 0 0			
Dec. 31	„ Interest on Drawings	..		7 14 0			
„ „	„ Balance *c/d.*	..	..	662 6 0			
				£900 0 0			£900 0 0
					19..		
					Jan. 1	By Balance *b/d.*	662 6 0

NOTES—(1) Percy's capital of £1,500 and Saunders' capital of £2,000 would appear in the respective partners' Capital Acounts.
(2) Alternatively, interest could be calculated by the average due date method shown in Chapter X.

one-half; Jones one-third; and Robinson one-sixth. Give the necessary entries rectifying the above omissions. (*See below.*)

To deal correctly with this question, it is necessary to ascertain the amount of each partners' capital at the beginning of the year. This is done in the following manner:—

PARTNERS' CAPITALS.

	Brown.	Jones.	Robinson.	Total.
	£	£	£	£
Closing Balances . .	4,000	3,000	2,000	9,000
Deduct Profits credited .	3,000	2,000	1,000	6,000
	1,000	1,000	1,000	3,000
Add Drawings . .	1,000	750	450	2,200
Commencing Balances .	£2,000	£1,750	£1,450	£5,200

After which, the journal entries are made as follows:—

19..			Dr. £ s. d.	Cr. £ s. d.
June 30	Profit & Loss Appropriation A/c. *Dr.*		260 0 0	
	To Capital Accounts:—			
	Brown, 5% on £2,000			100 0 0
	Jones, 5% on £1,750			87 10 0
	Robinson, 5% on £1,450			72 10 0
	Being interest on capital not credited.			
" 30	Capital Accounts:—			
	Brown . . . . . *Dr.*		25 0 0	
	Jones		18 0 0	
	Robinson		10 0 0	
	To Profit & Loss Appropriation Account			53 0 0
	Being interest on drawings omitted.			
" 30	Capital Accounts:—			
	Brown (one-half) . . . *Dr.*		103 10 0	
	Jones (one-third) . .		69 0 0	
	Robinson (one-sixth) . .		34 10 0	
	To Profit & Loss Appropriation Account			207 0 0
	Being adjustment of Profit and Loss Account for the year ended 30th June.			

Adjustments such as these should always be made by means of journal entries; it is not permissible in practice to cross out or to cancel the incorrect entries. The adjusting entries in the

Profit and Loss Appropriation Account and revised Capital Accounts are as follows :—

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT. *Cr.*

	£ s. d.	£ s. d.		£ s. d.	£ s. d.
To Interest on Capital not debited—			By Interest on Drawings omitted—		
Brown .	100 0 0		Brown .	25 0 0	
Jones .	87 10 0		Jones .	18 0 0	
Robinson .	72 10 0		Robinson .	10 0 0	
		260 0 0			53 0 0
			„ Balance transferred to Capital Accounts—		
			Brown .	103 10 0	
			Jones .	69 0 0	
			Robinson .	34 10 0	
					207 0 0
		£260 0 0			£260 0 0

Dr. BROWN'S CAPITAL ACCOUNT. *Cr.*

19..		£ s. d.	19..		£ s. d.
June 30	To Interest on Drawings	25 0 0	June 30	By Balance *b/d.* .	4,000 0 0
„ „	„ Profit and Loss Appropriation A/c. .	103 10 0	„ „	„ Interest on Capital	100 0 0
„ „	„ Balance *c/d.* . .	3,971 10 0			
		£4,100 0 0			£4,100 0 0
			July 1	By Balance *b/d.* .	3,971 10 0

Dr. JONES' CAPITAL ACCOUNT. *Cr.*

19..		£ s. d.	19..		£ s. d.
June 30	To Interest on Drawings	18 0 0	June 30	By Balance *b/d.*. .	3,000 0 0
„ „	„ Profit and Loss Appropriation A/c. .	69 0 0	„ „	„ Interest on Capital	87 10 0
„ „	„ Balance *c/d.* . .	3,000 10 0			
		£3,087 10 0			£3,087 10 0
			July 1	By Balance *b/d.* .	3,000 10 0

Dr. ROBINSON'S CAPITAL ACCOUNT. *Cr.*

19..		£ s. d.	19..		£ s. d.
June 30	To Interest on Drawings	10 0 0	June 30	By Balance *b/d.*. .	2,000 0 0
„ „	„ Profit and Loss Appropriation A/c. .	34 10 0	„ „	„ Interest on Capital	72 10 0
„ „	„ Balance *c/d.* . .	2,028 0 0			
		£2,072 10 0			£2,072 10 0
			July 1	By Balance *b/d.* .	2,028 0 0

Alternatively, the above adjustments could be made by means of transfers between the several partners' Capital (or Current) Accounts, through the medium of the Journal, the method of arriving at the net figures being shown in the form of a *memorandum* statement, as part of the narration. Thus, in the above example, the required Journal entry would be :—

		Dr. £ s. d.	Cr. £ s. d.
19..			
June 30	Brown—Capital Account *Dr.*	28 10 0	
	To Jones—Capital Account		10 0
	,, Robinson—Capital Account		28 0 0
	Being adjustment in respect of interest on capitals and drawings, as per following statement. . . .		

Where adjustments affecting two or more past years are involved, the *net effect* should be passed through the books in the form of a single Journal entry, on the lines of the above.

EXAMPLE

X, *Y* and *Z*, partners, have omitted interest on capitals for the three years ended 31st December, 1940. Their fixed capitals, upon which interest is based, were *X*, £2,000, *Y*, £1,600 and *Z*, £1,400 throughout the period of three years, but they shared profits in the following ratios respectively: 1938, 1:2:2; 1939, 5:3:2; 1940, 4:5:1. Adjust the position between the partners.

As the profit-sharing ratios differ in each year, a memorandum statement should be prepared as shown below, in order to ascertain the necessary double entry for the Journal.

Year.		*Interest on Capital.*	*Ratios.*	"*Divisible Loss.*"	*Adjustment.*	
				£	£ +	£ −
1938	*X* 5% on £2,000 . .	100	$\frac{1}{5}$	50	50	
	Y—5% on £1,600 . .	80	$\frac{2}{5}$	100		20
	Z—5% on £1,400 . .	70	$\frac{2}{5}$	100		30
		£250		£250		
1939	*X*—5% on £2,000 . .	100	$\frac{5}{10}$	125		25
	Y—5% on £1,600 . .	80	$\frac{3}{10}$	75	5	
	Z—5% on £1,400 . .	70	$\frac{2}{10}$	50	20	
		£250		£250		
1940	*X*—5% on £2,000 . .	100	$\frac{4}{10}$	100		
	Y—5% on £1,600 . .	80	$\frac{5}{10}$	125		45
	Z—5% on £1,400 . .	70	$\frac{1}{10}$	25	45	
		£250		£250	£120	£120

A formal entry will then be made, crediting *X* with £25 and debiting *Y* with £60 and crediting *Z* with £35.

Although, in the example on page 177, the net profit for the year is stated, the solution of problems of this nature is a simple matter even where such information is not given, being based on the principle of treating the adjustments as a profit (or a loss, as the case may be) *to the firm*, to be divided between the partners in the profit-sharing ratio.

EXAMPLE.

A, *B* and *C*, sharing profits equally, have capitals of *A*, £5,000; *B*, £4,000; *C*, £3,000. For the year 1940 interest on capital has been credited to them at 6% instead of 5%. Correct the error.

	A	B	C
	£	£	£
Interest credited in error at 6% .	300	240	180
Correct interest (5%)	250	200	150
Partners over-credited with . .	*Dr.* 50	*Dr.* 40	*Dr.* 30
The above adjustment has the effect of increasing the net profit by £120, divisible equally . .	*Cr.* 40	*Cr.* 40	*Cr.* 40
	Dr. £10	..	*Cr.* £10

A Journal entry would therefore be made, debiting *A*, and crediting *C*, with £10. *B* is unaffected by the adjustment, since the amount of interest on capital which he loses (1% on £4,000, or £40) is exactly balanced by his share of the firm's gain from the cancellation of the excessive interest on capitals.

Where the partners' capitals are fixed and/or the profit-sharing ratio has remained unaltered over a period of years, calculations affecting two or more past years may be combined, but where the profit-sharing ratio has changed, or where interest on capital is computed on the annual capital balances as altered by profits or losses and drawings, then a separate calculation for *each year* is essential.

Where the profit-sharing ratio varies according to the amount of profit made, the adjustments require careful working out, particularly where the net effect is to reduce the net profit, since it is then necessary to work backwards, reversing the division of the profits previously made.

EXAMPLE.

A and *B* are in partnership, sharing profits in the following manner :—

First £250—all to *A*.
Next £250—in ratio *A*, 4 ; *B*, 1.
Remainder—equally.

The accounts for 1940 show a net profit of £750, but it is discovered that *B* has not been credited with a salary of £250 to which he is entitled, and that interest at the agreed rate of 5% per annum has not been allowed on capitals (*A*, £5,000 ; *B*, £1,000).

The necessary adjustments will reduce the net profit by £550, which will be divided between the two partners in the following manner :—

	Total	A	B
	£	£	£
The original profit of £750 was divided :—			
All to *A*	250	250	..
A, $\frac{4}{5}$, *B*, $\frac{1}{5}$	250	200	50
A and *B* equally	250	125	125
	£750	£575	£175

In reducing the net profit by £550, it is necessary to begin with the last step in the above table and work upwards. Thus, in all, the last £250 (*A*, £125; *B*, £125) is cancelled ; the next £250 (*A*, £200 ; *B*, £50) is also wiped out ; and of the first £250, which belongs wholly to *A*, £50 is eliminated.

The net adjustment is therefore :—

	A	B
	£	£
Salary	..	250
Interest on Capital	250	50
	Cr. 250	*Cr.* 300
Decrease in profits, borne as above	*Dr.* 375	*Dr.* 175
	Dr £125	*Cr.* £125

A Journal entry would therefore be made, debiting *A* and crediting *B* with £125.

Professional Partnerships.

Partnerships may be formed for other purposes than trade, as, for example, partnerships of professional men, e.g., accountants, doctors and solicitors. In such cases the trading account is replaced by a "Costs Account," or one bearing some other appropriate designation.

EXAMPLE.

A. Green and L. Smith are Accountants practising in partnership, sharing profits in the proportions of three-fifths and two-fifths. They only divide profits arising out of Costs, etc., actually received. Smith is entitled to £500 salary; interest on Capital is calculated at 5%; each partner takes one-half of the Directors' Fees earned by him, the remainder being for General Account; write off proportion of Articled Clerks' premiums; write down Furniture and Fittings to £500. The following was the Trial Balance as at 31st December, 1940. Set out the "Costs" and "Directors' Fees" Accounts, prepare the Profit and Loss Account for the year to 31st December, 1940, and show the Balance Sheet as on that date.

TRIAL BALANCE AS AT 31ST DECEMBER, 1940.

	Dr.	*Cr.*
	£	£
Capital Account, A Green		1,800
" L. Smith		1,200
Drawings, A. Green	1,000	
" L. Smith	1,050	
Reserve for Costs, 31st December, 1939		3,750
Costs charged to Clients during 1940		6,200
Debtors for Costs	4,285	
" Disbursements	70	
Insurance Commissions received		340
Articled Clerks' Premiums (5 years from 1st January, 1940)		525
Directors' Fees, A. Green		200
" L. Smith		450
Salaries to Staff	2,840	
Auditors' Fees, Office Expenses, Rent, Stationery, etc.	1,370	
Furniture and Fittings	590	
Creditors, Clients		4,150
" Sundries		495
Cash at Bank, Firm's Account	3,480	
" Clients' Account	4,300	
Cash in hand	125	
	£19,110	£19,110

An interesting variation of "reserves" is illustrated in this question. By mutual agreement, the partners have decided to divide only the profits resulting from accounts which have actually been paid by their clients. Hence amounts unpaid for costs at the end of the year must be reserved for and not brought into account for division. This practice is not uncommon among professional men, particularly doctors, and while the reserve in this particular case may appear excessive, effect must be given in the accounts to any special agreement on such points.

DIRECTORS' FEES ACCOUNT.

Dr. FOR YEAR ENDED 31ST DECEMBER, 1940. *Cr.*

	£		£
To A. Green . .	100	By A. Green's Fees .	200
„ L. Smith . .	225	„ L. Smith's „ .	450
„ Balance transferred to Profit and Loss Account .	325		
	£650		£650

COSTS ACCOUNT.

Dr. FOR YEAR ENDED 31ST DECEMBER, 1940. *Cr.*

	£		£
To Reserve at 31st Dec. 1940, *c/d.* .	4,285	By Reserve at 31st Dec. 1939, *b/d.* .	3,750
„ Balance transferred to Profit and Loss Account .	5,665	„ Costs charged to Clients . .	6,200
	£9,950		£9,950
		By Reserve *b/d.* .	4,285

PROFIT AND LOSS ACCOUNT.

Dr. FOR YEAR ENDED 31ST DECEMBER, 1940. *Cr.*

	£		£
To Salaries . .	2,840	By Costs Received .	5,665
„ Sundry Expenses .	1,370	„ Directors' Fees .	325
„ Depreciation of Furniture and Fittings . .	90	„ Proportion of Articled Clerks' Premiums .	105
„ Balance *c/d.* . .	2,135	„ Insurance Commissions .	340
	£6,435		£6,435
To L. Smith, Salary .	500	By Balance *b/d.* .	2,135
„ Interest on Capital— A. Green . £90; L. Smith . 60	150		
„ Balance—			
A. Green, $\frac{3}{5}$ths .	891		
L. Smith, $\frac{2}{5}$ths .	594		
	£2,135		£2,135

Green and Smith.

BALANCE SHEET AS AT 31st DECEMBER, 1940.

Liabilities.	£	£	*Assets.*	£	£
Sundry Creditors—			Furniture and Fittings .	590	
Clients	4,150		*Less* Depreciation . .	90	
Sundries	495				500
		4,645	Sundry Debtors—		
Reserve for Costs (per contra) . . .		4,285	For Costs (per contra) .	4,285	
			For Disbursements . .	70	
Proportion unexpired of Articled Clerks' Premiums		420			4,355
			Cash at Bank—		
Capital Accounts—			Clients' Account .	4,300	
A. Green	1,800		Firm's Account . .	3,480	
L. Smith	1,200		Cash in Hand . . .	125	
		3,000			7,905
Current Accounts—					
A. Green, Director's Fees .	100				
Interest on Capital	90				
Profit, $\frac{3}{5}$th Share	891				
	1,081				
Less Drawings . .	1,000				
		81			
L. Smith, Director's Fees .	225				
Salary . .	500				
Interest on Capital	60				
Profit, $\frac{2}{5}$th Share	594				
	1,379				
Less Drawings . .	1,050				
		329			
		£12,760			£12,760

Goodwill and its Treatment in Partnership Accounts.

In a case which came before the courts in 1810, Goodwill was defined as "the probability that the old customers will resort to the old place" (Lord Eldon). The following much more comprehensive definition was given later by Lord Lindley :—

> "The term goodwill can hardly be said to have any precise signification. It is generally used to denote the benefit arising from connection and reputation, and its value is what can be got for the chance of being able to keep that connection and improve it. Upon the sale of an established business its goodwill has a marketable value, whether the business is that of a professional man or of any other person. But it is plain that goodwill has no meaning except in connection with a continuing business, and the value of the goodwill of any business to a purchaser depends, in some cases entirely, and in all very much, on the absence of competition on the part of those by whom the business has been previously carried on."

Goodwill is, of course, an intangible asset, and apart from the business itself it has no commercial or monetary value ; hence it cannot be realised except upon the sale of the business as a going concern.

There are three different classes of goodwill, viz. :—

(1) LOCAL, arising from the situation of the trader's premises ; e.g., a retail shopkeeper in a busy market centre.

(2) PERSONAL REPUTATION of the individual, arising through his skill and influence, as in the case of a professional man ; e.g., an accountant or doctor.

(3) THE REPUTATION OF THE GOODS SOLD, arising from the high standard of quality of the goods themselves ; e.g., a well-advertised brand of proprietary goods such as "Oxo."

A combination of any or all of these classes may exist in connection with a business.

On the purchase of a business the excess of the purchase price over the total value of the assets, less liabilities taken over, represents the amount paid for goodwill. This is debited to Goodwill Account, which usually remains at this original figure, being neither depreciated nor written up in value until a change takes place in the ownership of the business through sale or through the death or retirement of one of the partners or the admission of a new partner. On such occasions it becomes necessary to revalue the goodwill along with the other assets of the firm.

The goodwill of a business may belong to one partner only, or it may be shared by some or all the partners in certain proportions, according to the terms of the Partnership Deed. In the event of there being no special agreement upon the matter, goodwill belongs to all the partners in the proportions in which they share profits or losses.

Until recently the value of goodwill was generally based on the purchase of a certain number of years' average profits, e.g., three to five years' purchase. Recently, however, it has become customary to adopt a new basis, known as the "super profits" or "goodwill profits" basis of computing the value of goodwill. By this method only the excess of the average profits of a business over and above the normal commercial profits of a business of the nature concerned, is deemed to represent the goodwill portion of the profits, it being assumed that goodwill is represented only by the excess profits over and above the "investment" yield on the net capital employed in the business.

For example, if the average profits of a business over an agreed period amount to £17,000 per annum, and the normal commercial yield on capital invested in such a business is deemed to be 8 per cent. per annum, then, assuming the net capital invested in the business to be £100,000, the excess of the average profits (£17,000) over the normal profits (£8,000, i.e., 8 per cent. on £100,000) represents the "goodwill" or "super" profits. Thus,

in this case, the super profits amount to £9,000 per annum and this figure would be taken as the basis of the computation of goodwill. If goodwill were based on five years' purchase of the average super profits, the value attributable to goodwill would amount to £45,000.

Admission of a New Partner.

Subject to special agreement, a new partner can be admitted only with the consent of all the existing partners. On his admission into the firm the incoming partner acquires, by reason of his being a partner, the right to share in the profits, and the existing partners will expect to receive satisfactory compensation for the surrender of a part of these profits. The amount thus received is known as the "Premium" for the admission of the new partner.

Alternative methods of arranging this compensation are :—

(1) The raising of a Goodwill Account in the partnership books, or the adjustment of the existing Goodwill Account ; *or*

(2) The payment by the incoming partner of a sum of money as his admission fee, this fee being received by the old partners personally and not by the firm ; *or*

(3) The payment by the incoming partner of a premium as in (2), the amount so paid being retained in the business as additional working capital, and credited rateably to the old partners' Capital Accounts.

FIRST METHOD.—By this method, the amount agreed as the value of goodwill is debited to a Goodwill Account and credited to the old partners' capital accounts in the OLD profit-sharing ratio, thus increasing the amounts standing to their credit. Where partners are entitled to receive interest on capital, the old partners will be benefited and the new partner penalised in the annual distribution of profits to the extent of the interest on the additional capital, which is, of course, credited before the profits for division are calculated. Where no interest is provided for, the old partners will derive no benefit until dissolution, unless the profits are apportioned according to the amount of capital held by each of them.

It will be a matter for arrangement whether the new partner introduces any capital. If he does, cash (or an asset account) will be debited, and the new partner's capital account credited with the sum (or agreed value of the asset) introduced, *including* any sum brought in by the new partner in payment for his share

of the goodwill (for the old partners have already received the full amount of credit to which they are entitled in respect of that asset).

EXAMPLE.

A and *B*, who are in partnership, sharing profits and losses equally, decide to admit *C* into partnership. By the terms of the agreement, the goodwill of the business, valued at £5,000, is to be introduced into the firm's books, and *C* is required to provide a capital equal in amount to that of *B* after the latter has been credited with his share of the goodwill.

Show the Journal entries necessitated by the admission of *C*, and the opening Balance Sheet of the new firm.

The Balance Sheet immediately before the admission of *C* was as follows :—

Liabilities.	£	*Assets.*	£
Sundry Creditors . .	6,000	Sundry Assets	15,900
Capital Accounts—		Cash	100
A	6,000		
B	4,000		
	£16,000		£16,000

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	£	£
Goodwill Account . . . . . *Dr.*	5,000	
To *A*—Capital Account . . .		2,500
B—Capital Account . . .		2,500
Being creation of goodwill at the agreed valuation.		
Cash . . . . *Dr.*	6,500	
To *C*—Capital Account		6,500
Being capital introduced by C, as per agreement dated . . .		

BALANCE SHEET OF A, B, AND C.

Liabilities.	£	*Assets.*	£
Sundry Creditors . .	6,000	Goodwill	5,000
Capital Accounts—		Sundry Assets . .	15,900
A	8,500	Cash.	6,600
B	6,500		
C	6,500		
	£27,500		£27,500

If the new firm does not desire to retain the asset Goodwill in its books, it will be necessary to write it off to the capital accounts of the partners in the new firm (including the new

partner) in the *new* profit-sharing ratio. The procedure involved is similar to that outlined on page 191.

SECOND METHOD.—When the premium is paid to the old partners personally, no entries need be made in the partnership books, as it is purely a personal arrangement between the old and new partners, and the premium is not partnership property.

In order to obtain a record of the transaction in the firm's books, however, the money is usually paid into the partnership, and immediately withdrawn by the old partners.

EXAMPLE.

X and *Y* are in partnership, sharing profits in the proportion of two-thirds and one-third respectively. They decide to admit their manager, *Z*, as a partner, and in consideration of his paying to the existing partners a premium of £6,000 (which sum shall not be retained in the firm's business), and introducing a capital of £10,000, *Z* is to receive a share of the profits equal to one-fourth of that of *X*.

Set out the entries required to give effect to the above arrangement, and show the division of the first year's profits between *X*, *Y*, and *Z*, assuming that £42,000 was divisible.

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		£	£
	Cash . . . . *Dr.*	6,000	
	To *X*—Capital Account . . .		4,000
	„ *Y*—Capital Account . . .		2,000
	Being division of the premium payable by Z.		
	X—Capital Account . . . . *Dr.*	4,000	
	Y—Capital Account	2,000	
	To Cash		6,000
	Being withdrawal of the premium paid into the firm's account by Z.		
	Cash . . . . *Dr.*	10,000	
	To *Z*—Capital Account . . .		10,000
	Being capital introduced by Z as per agreement dated . . .		

The first year's profit would be divided as follows :—

	£
X (four-sevenths)	24,000
Y (two-sevenths)	12,000
Z (one-seventh)	6,000
	£42,000

NOTE : *Z* receives	1 part
X receives four times as much as *Z*, viz. . .	4 parts
Y receives half as much as *X*, viz. . . .	2 parts.
	7 parts

Where, as in the above example, the old partners continue to share profits between themselves in the same proportion as before, the premium received from the new partner is correctly divided between the old partners in their profit-sharing ratio. Where, however, the profit-sharing ratio in the new firm is altered as between the old partners, this method requires modifying. The premium is, in effect, a compensation to the original partners for the share of profits which they surrender to the new partner, and the premium should therefore be divided between the old partners *according to the proportion of profits which each surrenders.*

EXAMPLE.

A and *B* are in partnership, sharing profits 3 : 2. They admit *C* into partnership, *C* paying a premium of £1,000 for a one-fourth share of the profits; as between themselves, *A* and *B* agree to share future profits and losses equally. Show, by means of a Journal entry, the apportionment of the premium.

	A	*B*	*C*
Profit-sharing ratio (Old firm)	$\frac{3}{5}$	$\frac{2}{5}$	..
Profit-sharing ratio (New firm)	$\frac{3}{8}$	$\frac{3}{8}$	$\frac{1}{4}$
Shares gained and lost	$-\frac{9}{40}$	$-\frac{1}{40}$	$+\frac{1}{4}$

Therefore the premium of £1,000 received from *C* must be divided between *A* and *B* in the ratio 9 : 1.

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		£	£
Cash *Dr.*		1,000	
To *A*—Capital Account			900
,, *B*—Capital Account			100
Being division of the premium payable by C			

The entries dealing with the withdrawal of the premium by *A* and *B*, and with the capital introduced by *C*, will be on the same lines as those on page 190.

NOTES—(1) The above apportionment should be compared with the result which would have been obtained under the first method (see pages 188–190) if goodwill had first been brought into the books at its full value and credited to the old partners in the *old* profit-sharing ratio, and then eliminated by being debited to the new partners in the *new* profit-sharing ratio. [Since *C* pays £1,000 for a one-fourth share of the goodwill, its total value would appear to be £4,000.]

	A £	*B* £	*C* £
Goodwill written up in old profit-sharing ratio	2,400	1,600	..
Goodwill written down in new profit-sharing ratio	1,500	1,500	1,000
	+£900	+£100	−£1,000

(2) In questions of this type it should now be clear that, if the old partners continue to share profits and losses, as between themselves, in the same ratio as before, the division of the premium between them in the *old* profit-sharing ratio gives a correct result, since they had also surrendered their shares of profits to the new partner in that ratio. Thus, supposing that, in the above example, *A* and *B* had continued sharing profits and losses as between themselves in the ratio 3 : 2, the premium of £1,000 received from *C* would have been correctly divided in the ratio 3 : 2 (£600 to *A* and £400 to *B*), as may be proved from the following schedule:—

	A	*B*	*C*
Profit-sharing ratio (Old firm)	$\frac{3}{5}$	$\frac{2}{5}$	..
Profit-sharing ratio (New firm)	$\frac{9}{20}$	$\frac{6}{20}$	$\frac{1}{4}$
Shares gained and lost	$-\frac{3}{20}$	$-\frac{2}{20}$	$+\frac{1}{4}$

THIRD METHOD. By this method the premium is retained in the partnership as additional working capital, and the result is to increase the balances of the old partners' capital accounts. The entries required are :—

(1) Debit cash and credit the old partners' capital accounts, in the proportion in which they share profits or losses,* with the agreed amount of premium paid by the new partner.

(2) Debit cash and credit the new partner with the amount of capital (if any) which he introduces, i.e., total cash paid in, less the amount appropriated under (1).

Where a premium is paid it is usual to provide in the new partnership deed that if the partnership comes to an end before a stated date, a proportionate part of the premium shall be refunded to the person providing it. Alternatively, when the partnership is dissolved it may be mutually agreed that a proportionate part shall be refunded. In the absence of any agreement as to the return of premium on an earlier dissolution than was originally contemplated, the partner who paid the premium may not be able to recover any portion thereof ; the Court may, however, order repayment of such proportionate part as is considered just (according to the circumstances of the case), unless the dissolution is due to the premium-paying partner's own fault and misconduct.

Revaluation of Assets upon the Admission of a New Partner.

During the continuance of a firm's business, the profits are generally ascertained after providing due depreciation upon

* This is correct if the old partners continue to share profits and losses between themselves in the same ratio as before. If, as between themselves, the profit-sharing ratio has been altered, the premiums will be divided according to the proportion o profits which each surrenders (see page 191.)

certain assets, and valuing the stock-in-trade at cost or market price, whichever is lower.

Fluctuations or appreciation in the value of fixed assets are not, however, taken into account.

The values placed upon the firm's assets should be as nearly as possible their actual value to the business; but this is not always done, and, if it is decided to alter the constitution of the firm by the admission of a new partner, it then becomes necessary to review the book values of the firm's assets, and to adjust them where necessary, so that they represent the true values as arrived at by expert valuation.

This is done by journal entries, debiting any increase in the book values and crediting any decrease therein to the accounts of the assets concerned, and making corresponding entries in the capital accounts of the OLD partners, the net increase or decrease in the values being credited or debited, as the case may be, to the partners in the proportions in which they share profits and losses.

EXAMPLE.

A and *B* are in partnership, sharing profits and losses in the proportions of two-thirds and one-third respectively. The Balance Sheet at 31st December was as follows:—

Liabilities.	£	*Assets.*	£
Capital, *A*	15,000	Cash	1,000
,, *B*	10,000	Debtors	15,000
Creditors	2,000	Stock	22,000
Bank	15,000	Machinery	3,000
		Plant	1,000
	£42,000		£42,000

They admit *C* into partnership upon the following terms:—

(1) *C* to purchase one-quarter of the Goodwill for £2,500, and provide £10,000 as capital. Profits are to be divided in the proportion of one-half to *A*, one-quarter to *B*, and one-quarter to *C*.

(2) The machinery and plant are to be reduced by 10% and 5%, respectively, and a reserve is to be created for bad debts to the extent of £500. The stock is taken in at a valuation of £25,000.

(3) By withdrawals or additions, the capitals of *A* and *B* are to be made proportionate to that of *C* on the basis on which profits are divided.

Set out the entries relating to the above transactions in the firm's Journal and Bank Account. Write up the partners' Capital Accounts, and show the opening Balance Sheet of *A*, *B*, and *C*. No account for Goodwill is to be opened in the books of the firm.

JOURNAL.

			£ s. d.	£ s. d.
19.. Jan. 1	Bank Account . . *Dr.*		12,500 0 0	
	To *A*			1,666 13 4
	,, *B*			833 6 8
	,, *C*			10,000 0 0
	Being premium of £2,500 paid by C, divisible between A and B, in the proportions of ⅔ and ⅓ respectively, and £10,000 capital introduced by C, as per agreement dated . . .			
,, 1	Stock Account . . *Dr.*		3,000 0 0	
	To Machinery . . .			300 0 0
	,, Plant			50 0 0
	,, Bad Debts Reserve .			500 0 0
	,, *A*			1,433 6 8
	,, *B*			716 13 4
	Being adjustment in book values of assets as per agreement dated . . .			

Dr. BANK ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19.. Jan. 1	To *A* and *B*, Premium paid by *C*		2,500 0 0	19.. Dec. 31	By Balance .	*b/d.*	15,000 0 0
,, 1	,, *A*. Capital Introduced		1,900 0 0	19.. Jan. 1	,, *B*. Capital Withdrawn		1,550 0 0
,, 1	,, *C*. Capital Introduced		10,000 0 0				
,, 1	,, Balance .	*c/d.*	2,150 0 0				
			£16,550 0 0				£16,550 0 0
				19.. Jan. 1	By Balance .	*b/d.*	2,150 0 0

Dr. A. CAPITAL ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19.. Jan. 1	To Balance .	*c/d.*	20,000 0 0	19.. Dec. 31	By Balance .	*b/d.*	15,000 0 0
				19.. Jan. 1	,, Bank, Premium paid by *C* .		1,666 13 4
				,, 1	,, Adjustment of Assets .		1,433 6 8
				,, 1	,, Bank, Capital Introduced .		1,900 0 0
			£20,000 0 0				£20,000 0 0
				19.. Jan. 1	By Balance .	*b/d.*	20,000 0 0

Dr. B. CAPITAL ACCOUNT. Cr.

			£ s. d.				£ s. d.
19.. Jan. 1	To Bank, Capital Withdrawn .		1,550 0 0	19.. Dec. 31	By Balance .	b/d.	10,000 0 0
" 1	" Balance .	c/d.	10,000 0 0	19.. Jan 1	" Bank, Premium paid by *C* .		833 6 8
				" 1	" Adjustment of Assets.		716 13 4
			£11,550 0 0				£11,550 0 0
				19.. Jan. 1	By Balance .	b/d.	10,000 0 0

Dr. C. CAPITAL ACCOUNT. Cr.

							£ s. d.
				19.. Jan. 1	By Bank .		10,000 0 0

A. B. AND C.

BALANCE SHEET AS AT 1ST JANUARY, 19..

Liabilities.	£	£	*Assets.*	£	£
Sundry Creditors . .		2,000	Plant		950
Bank		2,150	Machinery . . .		2,700
Capital Accounts—			Stock		25,000
A	20,000		Sundry Debtors . .	15,000	
B	10,000		*Less* Reserve for Bad Debts . . .	500	
C	10,000				14,500
		40,000	Cash		1,000
		£44,150			£44,150

NOTE.—Alternatively, the increases or decreases in the book values of the assets may be transferred to a Revaluation Account, the net balance on which will be closed off to the old partners' Capital Accounts in the old profit-sharing ratio. Thus, in the above example, the Revaluation Account would appear as follows :—

Dr. REVALUATION ACCOUNT. Cr.

			£ s. d.				£ s. d.
19.. Jan. 1	To Machinery . .		300 0 0	19.. Jan. 1	By Stock .		3,000 0 0
" 1	" Plant . . .		50 0 0				
" 1	" Bad Debts Reserve		500 0 0				
" 1	" Capital Accounts—						
	A . . .		1,433 6 8				
	B . . .		716 13 4				
			£3,000 0 0				£3,000 0 0

Although it is necessary to revalue the assets and liabilities on the occasion of a change in the constitution of a firm, the partners may prefer to retain the old values in the books, in which case the entries in the Revaluation Account will not be transferred to the relative asset or liability accounts, but will be carried down on the Revaluation Account and transferred to the Capital Accounts of the NEW partners in the NEW profit-sharing ratio.

EXAMPLE.

The Balance Sheet, at 1st January, 19.., of *A* and *B*, who share profits and losses in the ratio of 3 : 2, is as under :—

BALANCE SHEET AS AT 1ST JANUARY, 19..

Liabilities.	£	£	*Assets.*	£	£
Sundry Creditors		4,000	Freehold Property		10,000
Capital Accounts—			Plant and Machinery		5,000
A . . .	10,000				
B . . .	10,000				
		20,000	Stock . .		4,000
			Sundry Debtors		3,000
			Cash . .		2,000
		£24,000			£24,000

As at that date, *C* is admitted as a partner, the future profit sharing ratio to be 3 : 2 : 1. The following adjustments require to be made to the book values of the assets, but the firm does not desire them to be permanently recorded :—

(i) Freehold Property is worth £12,500.
(ii) Stock should be reduced by 10%.
(iii) Patents, valued at £900, have never appeared in the books.

Ignoring the questions of goodwill and of the capital introduced by *C*, prepare Revaluation Account and partners' Capital Accounts, giving effect to the above adjustments.

Dr. REVALUATION ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Stock . . .	*c/d.*	400	Jan. 1	By Freehold Property .	*c/d.*	2,500
„ 1	„ Capital Accounts—			„ 1	„ Patents . .	*c/d.*	900
	A—$\frac{3}{5}$ . . .		1,800				
	B—$\frac{2}{5}$ . . .		1,200				
			£3,400				£3,400
Jan. 1	To Freehold Property and Patents (reversal of above credits) .	*b/d.*	3,400	Jan. 1	By Stock (reversal of above debit) . .	*b/d.*	400
				„ 1	„ Capital Accounts—		
					A—$\frac{3}{6}$ . . .		1,500
					B—$\frac{2}{6}$ . . .		1,000
					C—$\frac{1}{6}$ . . .		500
			£3,400				£3,400

Dr. *A.* CAPITAL ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Profit on Revaluation written back . .		1,500	Jan. 1	By Balance . .	*b/d*	10,000
„ 1	„ Balance . . .	*c/d*	10,300	„	„ Profit on Revaluation		1,800
			£11,800				£11,800
				Jan. 1	By Balance . .	*b/d*	10,300

Dr. *B.* CAPITAL ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Profit on Revaluation written back . .		1,000	Jan. 1	By Balance . .	*b/d*	10,000
„ 1	„ Balance . . .	*c/d*	10,200	„ 1	„ Profit on Revaluation		1,200
			£11,200				£11,200
				Jan. 1	By Balance . .		10,200

Dr. *C.* CAPITAL ACCOUNT. *Cr.*

19..			£				
Jan. 1	To Profit on Revaluation written back . .		500				

NOTE.—The question of Goodwill has been ignored in the above example, but if a Goodwill Account had been opened (as in the example on page 189) it would, if necessary, be written back to the Capital Accounts of the new partners in the new profit-sharing ratio.

It may at first sight seem that, in the above example, the incoming partner is penalised as a result of writing back the increase in value of the assets, but it should be borne in mind that the undisclosed increases and decreases in value still exist in actual fact, and that, upon the next change in the constitution of the firm, they must again be revalued and dealt with on similar lines. In this connection a change may involve either :—

(i) An actual alteration in the membership of the firm (e.g., the admission of a partner; the retirement of a partner; the retirement of a partner accompanied by the admission of another partner; etc.).

(ii) A change in the profit-sharing ratio, unaccompanied by any alteration in the membership of the firm. Thus, if from 1st January, 1941, the firm *A*, *B* and *C*,

who have hitherto shared profits and losses in the ratio 3 : 2 : 1, change the ratio to 4 : 2 : 1, there has, for book-keeping purposes, been a change in the constitution of the firm; the old firm of *A*, *B* and *C*, sharing profits and losses 3 : 2 : 1, has come to an end, and the new firm of *A*, *B* and *C*, sharing profits and losses 4 : 2 : 1, has come into existence.

In the absence of an agreement to the contrary, all assets and liabilities must be brought in at their "fair value" (where this differs from current book value) on the occasion of any change in the constitution of a partnership (*Cruikshank* v. *Sutherland*, 1922); for example, both undisclosed assets and under-valued assets must be taken into account.

Admission of Partner by Purchase of Share.

When a new partner is admitted to a firm, the agreement may provide either (*a*) that he shall contribute sufficient to give him a specific share of the firm's net assets (as increased by his contribution), or (*b*) that he shall purchase his share, in a defined manner from one or more of the existing partners, the total capital of the business remaining unaltered. The book-keeping significance of these alternative arrangements is illustrated in the following example:—

EXAMPLE.

The Balance Sheet at 31st December, 19.., of *A* and *B*, who share profits and losses in the ratio 3 : 2, is as under:—

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Sundry Liabilities . .	2,000	Sundry Assets . .	12,000
Capital Accounts—			
A	6,000		
B	4,000		
	£12,000		£12,000

C is admitted as a partner on the first day of the following year. Ignoring the question of goodwill, prepare the opening Balance Sheet of *A*, *B* and *C*, on the footing:—

(*a*) That *C* contributes sufficient capital to give him a one-fifth share in the new firm.

(*b*) That *C* purchases a one-fifth share in the business from *A*.

(*a*) BALANCE SHEET AS AT 1ST JANUARY, 19..

Liabilities.	£	*Assets.*	£
Sundry Liabilities . .	2,000	Sundry Assets . .	12,000
Capital Accounts—		Cash (introduced by *C*) .	2,500
A	6,000		
B	4,000		
C	2,500		
	£14,500		£14,500

NOTE.—Since *C* is to obtain a one-fifth interest in the new firm, the combined capitals of the new firm will be five-fourths that of the old firm, or £12,500. *C* therefore brings in £2,500.

(*b*) BALANCE SHEET AS AT 1ST JANUARY, 19..

Liabilities.	£	*Assets.*	£
Sundry Liabilities . .	2,000	Sundry Assets . .	12,000
Capital Accounts—			
A	4,000		
B	4,000		
C	2,000		
	£12,000		£12,000

NOTE.—Since *C* is to purchase a one-fifth share in the business *from A*, the combined capitals will remain unchanged. *C* therefore purchases one-fifth of £10,000 = £2,000, and effect will be given to this in the books by debiting *A*'s Capital Account and crediting *C*'s Capital Account with that sum. It is not essential to record in the firm's books the cash passing from *C* to *A*.

Adjustment of Partnership Profits.

From time to time examiners set problematic questions dealing with adjustments of partnership profits. Most of these questions are really arithmetical problems, no book-keeping being involved. The following are typical examples :—

EXAMPLE 1.

John Great agrees to take Edward Lloyd into partnership. Lloyd was to bring in £6,000. Of this, £2,205 was to be paid for a three-sevenths' share of Great's profits, calculated at two years' purchase of their average amount, and the remainder was to be Lloyd's capital. Great was to leave one-half of this purchase money in the concern, in order to make his capital up to half as much

again as that of Lloyd. What were Great's average profits, and what was his capital before the partnership?

$$£2{,}205 = \tfrac{3}{7} \text{ of two years' profits.}$$

$$\therefore \text{One year's profits} = \frac{£2{,}205 \times 7}{2 \times 3}$$

$$= £2{,}572\ 10s., \text{ Great's average profits.}$$

		£	s.	d.
Lloyd's capital (£6,000 − £2,205)	=	3,795	0	0
Half as much again	=	5,692	10	0
Great leaves half of purchase money of share of profits (£2,205) in business	=	1,102	10	0
Balance, being Great's capital before the partnership	=	£4,590	0	0

EXAMPLE 2.

A commences a business on 1st January, with a capital of £8,000. On 1st April *B* is admitted, bringing in £6,000. *A* and *B* decide on 1st July to admit *C*, who introduces capital to the amount of £4,000. On 1st October *A* finds £2,000 more capital. The profits for the first year are £3,000, and are to be divided in proportion to the capital of each partner, having regard to the dates upon which capital was contributed.

Show the amount due to the partners at the end of the first year, indicating the method employed in arriving at the distribution.

			£	£
A's Capital :—				
£8,000 for 12 months.	8,000 × 12	=	96,000	
£2,000 for 3 „	2,000 × 3	=	6,000	
				102,000
B's Capital, £6,000 for 9 months.	6,000 × 9	=		54,000
C's Capital, £4,000 „ 6 „	4,000 × 6	=		24,000
				£180,000

			£
A receives	$\frac{102{,}000}{180{,}000}$ of £3,000	=	1,700
B „	$\frac{54{,}000}{180{,}000}$ of £3,000	=	900
C „	$\frac{24{,}000}{180{,}000}$ of £3,000	=	400
			£3,000

EXAMPLE 3.

A and *B* are partners. They admit *C* into partnership, agreeing to share profits in the future in the proportions of: *A*, one-half; *B*, one-third; and *C*, one-sixth. It is agreed, however, that *C*'s share of profits shall not be less than £1,500 in any one year. The profits for the first year were £8,100. Show the division of the profits.

	£
Total Profits	8,100
Less C's guaranteed share	1,500
Balance . .	£6,600

The balance is divisible between *A* and *B* in the same proportion as their agreed shares, i.e. :—

$\frac{1}{2}:\frac{1}{3}$ or $\frac{3}{6}:\frac{2}{6}$ or 3 : 2. *A* receives $\frac{3}{5}$ and *B* $\frac{2}{5}$ of £6,600.	£
A's share : $\frac{3}{5}$ of £6,600	3,960
B's share : $\frac{2}{5}$ of £6,600	2,640
C's share :	1,500
	£8,100

EXAMPLE 4.

Stock and Bond are equal partners. They admit Jones into partnership and allow him one-eighth share of the profits, such share to be borne by Stock, who was relieved of active management in the firm. Show the division of the profits, assuming that the profits for the first year amount to £7,280.

		£	£
Stock's share of profits $=\frac{1}{2}$ of £7,280	=	3,640	
Less Jones' share		910	
			2,730
Bond's share of profits $=\frac{1}{2}$ of £7,280	=		3,640
Jones' „ $=\frac{1}{8}$ of £7,280	=		910
			£7,280

EXAMPLE 5.

Clarke is offered a partnership by Hutch and is given the following alternatives :—

(1) A salary of £450 per annum plus a fifth share in profits after charging such salary ; or
(2) A quarter share of profits, without salary, but carrying a guarantee by Hutch of a minimum of £400 per annum.

Show which alternative is preferable, ignoring such factors as the nature and prospects of the business, etc.

When the profit level is low a comparison must be made between the salary plus share of profits (or minus share of loss) and the guaranteed minimum ; the comparison may be effected algebraically as follows :—

$$\begin{aligned} &\text{Let P} = \text{profits.} \\ &\text{Then } £450 + \frac{P - £450}{5} = £400. \\ &\text{i.e., } £2{,}250 + P - £450 = £2{,}000. \\ &\therefore P = £200. \end{aligned}$$

If the profits are exactly £200, then Clarke will obtain :—

Alternative (1) £450—[$\frac{1}{5}$ of £250 (i.e., £450—£200)]=£400.
Alternative (2) Guaranteed minimum . . =£400.

Thus if the profits are under £200 the guaranteed minimum (2) is preferable.

Where the profit level is high a comparison must be made between the salary plus one-fifth share of profits and one-quarter share of profits without salary, viz. :—

$$\begin{aligned} &\text{Let P} = \text{profits.} \\ &\text{Then } \frac{P}{4} = £450 + \frac{P - £450}{5} \\ &\text{i.e., } 5\,P = £9{,}000 + 4\,P - £1{,}800 \\ &\therefore P = £7{,}200. \end{aligned}$$

If the profits are exactly £7,200, then Clarke will obtain :—

Alternative (1) £450+[$\frac{1}{5}$ of £6,750 (i.e., £7,200—£450)]=£1,800.
Alternative (2) $\frac{1}{4}$ of £7,200 . . . . =£1,800.

Thus if the profits exceed £7,200, alternative (2) is preferable, whereas if the profits are between £200 and £7,200, alternative (1) is preferable.

The Amalgamation of the Businesses of Two Sole Traders.

When two or more persons, who have been trading separately, decide to carry on their businesses jointly as a firm, it is usually desirable to close the existing sets of books, and to open a new set, recording all assets, liabilities, and transactions of the partnership.

The amount of each partner's capital in the firm must be ascertained. This is done by deducting the total of the liabilities (if any) taken over by the firm from the total agreed value of the assets of his business which are transferred to the partnership.

The firm's books are then opened by debiting sundry asset accounts, crediting any liability accounts which may be necessary, and crediting the partners' capital accounts with sums equivalent to the net assets (as revalued, if necessary) contributed by them.

EXAMPLE.

On 1st January, *A* and *B*, who had previously been engaged in competitive businesses, agreed to become partners and amalgamate. The Balance Sheets of the two concerns on 31st December of the previous year were as follows :—

A's Balance Sheet.

Liabilities	£	*Assets.*	£
Creditors . . .	3,000	Premises	20,000
Bills Payable . . .	6,000	Plant and Machinery .	5,000
Capital . . .	100,000	Furniture and Fixtures .	500
		Investments . . .	2,000
		Stock	50,000
		Debtors . . .	30,000
		Bank	1,500
	£109,000		£109,000

B's Balance Sheet.

Liabilities.	£	*Assets.*	£
Creditors	25,000	Plant and Machinery .	20,000
Bank	10,300	Furniture . . .	300
Capital	105,000	Stock	75,000
		Debtors . . .	45,000
	£140,300		£140,300

A valuation of the assets of both businesses was made, and it was agreed that the Premises and Plant and Machinery belonging to *A* should be taken over by the new firm at £25,000 and £10,000 respectively. *B* was to be credited with £5,000 as the value of certain Patent Rights he possessed, which became the property of the partnership, but were not included in his Balance Sheet. All the other assets were taken over at the values stated in the respective balance sheets, except the Investments and Bank Balance belonging to *A*, which were not

taken over. Both men undertook to discharge their own liabilities, and it was agreed that *A* should introduce cash to make his capital equal to that of *B*. Prepare a journal entry opening the firm's books, and also a Balance Sheet of the firm.

JOURNAL.

			£	£
19..				
Jan. 1	Sundries . . . . . . *Dr.*			
	To Sundries :—			
	Stock		125,000	
	Debtors		75,000	
	Premises		25,000	
	Plant and Machinery		30,000	
	Furniture and Fixtures . . .		800	
	Patents		5,000	
	Cash		29,800	
	To *A*			145,300
	,, *B*			145,300
	Being assets of A and B taken over as per agreement dated . . .			
			£290,600	£290,600

A AND B.

BALANCE SHEET AS AT 1ST JANUARY, 19...

Liabilities.	£	*Assets.*	£
Capital Accounts :—		Premises	25,000
A	145,300	Plant and Machinery .	30,000
B	145,300	Patents	5,000
		Furniture and Fixtures .	800
		Stock	125,000
		Debtors	75,000
		Cash	29,800
	£290,600		£290,600

Adjustments on the Retirement of a Partner.

Upon the retirement of a partner, it becomes necessary to ascertain the amount due to him by the firm on account of capital and profits.

This may be determined by reference to a balance sheet of the firm prepared as at the date of retirement, or by adding to the outgoing partner's capital, as shown in the last agreed balance sheet, a sum to cover his share of the profits, less drawings, between the end of the last balancing period and the date of his retirement.

Any provisions in the Articles of Partnership as to the method of ascertaining the amount due to an outgoing partner must be observed, and if it becomes necessary to revise the book values

of the assets, e.g., by the inclusion of goodwill, appropriate journal entries must be made in the firm's books. These will be similar in nature to those occasioned on the admission of a new partner (see page 188), and will have the effect of bringing the combined balances of the outgoing partner's capital and current accounts up to the amount payable to him by the remaining partners. As in the example on page 196, the new firm may, if it desires, retain the old values of the assets in its books by reversing the entries made at the date of the partner's retirement.

If the amount due to the retiring partner is paid forthwith, cash will be credited and his capital and current accounts closed, but if payment is deferred, the balances of these accounts must be transferred to the credit of a loan account, which will be credited periodically with interest at the agreed rate, and debited with payments on account until the balance is extinguished.

Adjustments on the Death of a Partner.

From the accountancy point of view, the only difference between the retirement and death of a partner is that, in the former event the retiring partner's share, if not paid at once, is credited to a loan account in the name of the outgoing partner, whereas in the case of a partner's death, the adjusted balances of his capital and current accounts are transferred to an account headed "Executors (or Administrators) of —— deceased," pending payment. It is customary in practice for a firm to take out a partnership survivorship (or joint life) policy. The policy moneys are payable on the death of a partner and provide funds with which to discharge the amount due to such partner's estate. The annual premiums are charged against the firm's profits. The capital moneys received are divisible in the same ratio as profits, unless (as an alternative to charging the premiums wholly against revenue) a Policy Account has been written up in the books, in which case any excess of the policy monies received over the balance of the Policy Account in the books, will be divided in the profit-sharing ratio.

It is essential to note also that where there are separate policies on the lives of the several partners, the death of one partner will only cause his policy to mature; the other policies, being partnership assets, must then be brought into the books at their surrender values if they do not already so appear. The same situation arises when one partner retires before maturity of the policy(ies). It should be borne in mind that on the admission of a new partner before a claim under the policy has arisen, he must purchase his share of the unrecorded asset in the same way as unrecorded goodwill.

While a retirement is usually arranged to take place on the date of the firm's ordinary periodical balance sheet, the death of a partner generally occurs between balancing periods, and, to avoid the necessity of preparing special accounts to the date of death, it is frequently provided in Articles of Partnership that, in the event of the death of a partner, his share of the accruing profits is to be arrived at by taking a stated percentage per annum on his capital at the date of the last balance sheet, such percentage being calculated for the period from the date of the last accounts to the date of death.

Ordinarily an outgoing partner's right to share in the profits of the firm terminates at the date of retirement or death, but where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm without any final settlement of accounts as between the firm and the outgoing partner or his estate, then, in the absence of agreement to the contrary, the outgoing partner or his estate is entitled, by Section 42 (1) of the Partnership Act, 1890, at the option of himself or his representatives, to either :—

(*a*) Such share of the profits made since the dissolution as the Court may find to be attributable to the use of his share of the partnership assets ; *or*

(*b*) Interest at the rate of 5 per cent. per annum on the amount of his share of the partnership assets.

EXAMPLE I.

A, *B*, *C*, and *D* are in partnership sharing profits in the proportions of 8/24ths, 7/24ths, 6/24ths, and 3/24ths respectively.

On 31st December, 1940, at which date *A* retires, the Balance Sheet of the firm is as follows:—

A, B, C, AND D.

BALANCE SHEET.

Liabilities.	£	£	*Assets.*	£	£
Sundry Creditors .		3,182	Goodwill . .		9,000
Current Accounts :—			Sundry Assets .		19,645
A . . .	972				
B . . .	532				
C . . .	1,031				
D . . .	428				
		2,963			
Capital Accounts :—					
A . . .	9,000				
B . . .	6,000				
C . . .	5,000				
D . . .	2,500				
		22,500			
		£28,645			£28,645

The partnership deed provides that, in the event of a partner retiring, assets and liabilities are to be taken at book value, except Goodwill, which is to be valued at three times the average annual profits of the five years immediately preceding, which were as follows :—

1936, £3,807 ; 1937, £4,892 ; 1938, £7,856 ; 1939, £5,135 ; 1940, £2,075.

You are required to ascertain the amount due to *A* on his retirement and to show the opening Balance Sheet of the firm *B*, *C*, and *D*, assuming the liability to *A* to stand temporarily as a loan, the remaining partners' capital and current accounts to remain at their original figures.

GOODWILL.

Average of 5 years' profits $= \dfrac{£3{,}807+4{,}892+7{,}856+5{,}135+2{,}075}{5}$

$= \dfrac{£23{,}765}{5} = £4{,}753$

Total Goodwill $= £4{,}753 \times 3$
$= £14{,}259$

A's share of Goodwill, 8/24ths of £14,259
$= £4{,}753$

JOURNAL.

			£	£
1940 Dec. 31	Goodwill Account . . . . . *Dr.*		1,753	
	To *A*—Loan Account			1,753
	Being the proportionate share of increase in the value of Goodwill, viz.:—			
	Present Total Value, . . £14,259			
	„ *Book Value* . . 9,000			
	„ *Increase* . . £5,259			
	A's share thereof 8/24*ths* . £1,753			
Dec. 31	Sundries . . . . *Dr.*			
	To *A's* Loan Account			9,972
	A—Capital Account		9,000	
	A—Current Account		972	
	Being balances transferred.			

Dr. *A.*—LOAN ACCOUNT. **Cr.**

			£				£
1940 Dec. 31	To Balance	*c/d.*	11,725	1940 Dec. 31	By Goodwill . .		1,753
				„ „	„ Capital Account .		9,000
				„ „	„ Current Account .		972
			£11,725				£11,725
				1941 Jan. 1	By Balance . .	*b/d.*	11,725

B, C, AND D.

BALANCE SHEET AS AT 1st JANUARY, 1941.

Liabilities.	£	£	*Assets.*	£	£
Creditors . . .		3,182	Goodwill . . .		10,753
A—Loan Account .		11,725	Sundry Assets . .		19,645
Current Accounts :—					
B	532				
C	1,031				
D	428				
		1,991			
Capital Accounts :—					
B	6,000				
C	5,000				
D	2,500				
		13,500			
		£30,398			£30,398

EXAMPLE II.

Smith and Jones are in partnership as merchants, sharing profits and losses equally. Under their partnership agreement, interest is allowed on capital at the rate of 6% per annum. The agreement also contains a provision that, in the event of the death of either partner, the goodwill is to be valued at one year's purchase of the average profits of the three preceding years : and, in order to avoid the necessity of a stocktaking, the deceased partner's share in the accruing profits is to be calculated by allowing 10% per annum on his capital from the date of the last balance sheet to the date of his death.

Jones died on 31st March, 1941. Accounts were taken on 31st December, 1940, on which date the capitals were : Smith, £4,000, and Jones, £5,000. The profits of the three years ended 31st December, 1940 averaged £1,500 per annum. The balances of the partners' current accounts to 31st December, 1940, had been carried to the respective capital accounts, and Jones had drawn £100 in 1941. Compute the amount Smith has to pay to Jones' Estate.

Dr. THE EXECUTORS OF JONES (DECEASED). *Cr.*

			£				£
1941				1941			
Mar. 31	To Drawings . .		100	Mar. 31	By Capital Account as at 1st Jan., 1941 .		5,000
„ 31	„ Balance . .	*c/d.*	5,850	„ 31	„ Interest on Capital for 3 months at 6% per annum .		75
				„ 31	„ Accruing profits, 10% per annum on £5,000 . .		125
				„ 31	„ Share of Goodwill (½ of £1,500) .		750
			£5,950				£5,950
				Apr. 1	By Balance . .	*b/d.*	5,850

Limited Partnerships.

Since a limited partner is only liable for the firm's debts to the extent of the amount of capital which he has agreed to contribute, it follows that, if trading losses are incurred by a limited partnership, a limited partner cannot be called upon to contribute any further capital in respect of his share of the loss. His capital account should therefore be retained at the amount which he has contributed to the firm, and his share of the trading loss should be debited to his current account.

EXAMPLE.

A, *B* and *C* are in partnership, sharing profits 3 : 2 : 1. *A* and *B* are general partners, and *C* is a limited partner, with a capital of £1,500. During 1939 (the first year of the partnership) a loss of £1,200 was sustained. The Balance Sheet entries at 31st December, 1939, so far as *C* is concerned, will therefore be :—

Liabilities.	£	*Assets*	£
Capital Accounts—		Current Accounts—	
C	1,500	*C*	200

Nevertheless, although, in the above example, *C* cannot be compelled to contribute cash to clear off the debit balance on his current account, he cannot make any drawings on account of subsequent profits until the existing debit balance has been made good, for the profits are treated as first making good his share of accumulated past losses. If he should make any drawings in such circumstances, or if he makes drawings in anticipation of profits which do not materialise, he is regarded as having withdrawn part of his capital and is under an obligation to make good the deficiency. In order to emphasise the nature of a debit balance arising from excess drawings, it should not be left in the limited partner's current account, but should be deducted from the credit balance on his capital account, thus indicating the amount which the limited partner must pay in to make good his fixed capital contribution.

EXAMPLE.

Facts as in previous example. The results for the years 1940 and 1941 were :—

1940. Net Profit, £1,800. *C*'s drawings, £50.

1941. Net Profit, £1,500. *C*'s drawings, £400.

Show *C*'s Current Account for the two years in question, together with the entries in the Balance Sheets at the end of each year, so far as they affect *C*.

Dr. *C.* CURRENT ACCOUNT. *Cr.*

1940			£	1940			£
Jan. 1	To Balance . . .	*b/d*	200	Dec. 31	By Profit and Loss Account, Share of Profits . . .		300
Dec. 31	„ Drawings . .		50				
„ „	„ Balance . . .	*c/d*	50				
			£300				£300
1941				1941			
Dec. 31	To Drawings . .		400	Jan. 1	By Balance . .	*b/d*	50
				Dec. 31	„ Profit and Loss Account, Share of Profits . .		250
				„ „	„ Capital Account: excess drawings transferred . . .		100
			£400				£400

BALANCE SHEET AS AT 31st DECEMBER, 1940.

Liabilities.	£	*Assets.*	£
Capital Accounts—			
C	1,500		
Current Accounts—			
C	50		

BALANCE SHEET AS AT 31st DECEMBER, 1941.

Liabilities.	£	£	*Assets.*	£
Capital Accounts—				
C . . .	1,500			
Less Excess drawings . .	100			
		1,400		

C's share of the profits for 1940 must be applied primarily in making good the debit balance brought forward on his current account from the previous year. This leaves £100 against which *C* is entitled to draw, and of this sum he has withdrawn £50, leaving £50 to be carried forward to 1941.

During 1941 *C* can only permissibly make drawings to the extent of £300 (Profit for the year £250 *plus* credit balance brought forward £50). His excess drawings of £100 therefore represent an unauthorised withdrawal of capital, and should be made good by contribution from *C*.

Rule in Elliott *v.* Elliott.

Arrangements made by partners as to the procedure to be followed upon the death of one of their number are not always free from complications. Thus in *Elliott* v. *Elliott*, 1911, the articles of partnership provided that, upon the death of any partner, the survivors should purchase his share by instalments in the proportions in which profits were shared.

One of the partners died in 1906, and the new firm treated his share as a debt due from the firm. In 1911, before the final instalments had been paid, another partner died, and it had to be determined whether the remaining instalments were due from the new firm or from the individual partners. It was held that in such circumstances the outstanding liability to the estate of the first deceased partner was not a debt of the new firm, but a series of debts due from the surviving partners in the proportions in which they shared the profits of the original firm.

In order to give effect to this decision the balance on the deceased partner's capital account should be transferred to the remaining partners' capital accounts in the profits ratio of such partners. The firm's balance sheet, drawn up after the death of the late partner, will thus show no balance relating to the estate of such partner, but will show augmented capital accounts for the continuing partners, the liability to the deceased partner's estate being a liability of the several partners individually and not of the firm.

EXAMPLE.

R, *S* and *T* are in partnership, sharing profits and losses in the ratios of one-half, one-third and one-sixth respectively. *R* retires as from 31st December, when the Balance Sheet of the partnership was as follows:—

BALANCE SHEET.

Liabilities.	£	*Assets.*	£
Capital Accounts—		Sundry Net Assets .	15,000
R	6,000		
S	5,000		
T	4,000		
	£15,000		£15,000

Show the amended Balance Sheet after the retirement of *R*:—

(1) Applying the rule in *Elliott* v. *Elliott*.
(2) Ignoring the rule in *Elliott* v. *Elliott*.

(1) BALANCE SHEET.

Liabilities.	£	*Assets.*	£
Capital Accounts—		Sundry Net Assets .	15,000
S	9,000		
T	6,000		
	£15,000		£15,000

In the above case the credit balance on *R*'s Capital Account has been transferred to *S* and *T* in their new profit ratios of 2 : 1, i.e., *S* £4,000 and *T* £2,000. Thus the individual partners are personally liable to *R* for the respective amounts transferred to their Capital Accounts.

(2) BALANCE SHEET.

Liabilities.	£	*Assets.*	£
Capital Accounts—		Sundry Net Assets .	15,000
S	5,000		
T	4,000		
R Loan Account . . .	6,000		
	£15,000		£15,000

In the second case the amount due to *R* is a debt of the firm, in respect of which both the surviving partners are jointly and severally liable.

As the application of the rule in *Elliott* v. *Elliott* may be inequitable in certain cases, e.g., where a surviving partner becomes bankrupt, it is advisable to include a clause in the partnership deed that amounts due to the estate of a deceased partner are a liability of the firm.

EXERCISE 6

A. What are the rights and duties set forth in the Partnership Act, 1890, with reference to the following:—

(*a*) Interest on Capital;
(*b*) Advances to the Firm by a Partner;
(*c*) Payments made by a Partner on behalf of the Firm;
(*d*) Management of the Business;
(*e*) Partners' Salaries;
(*f*) Introduction of new Partners;
(*g*) Disputes arising from the Partnership?

B. What are the advantages and disadvantages of Limited Partnerships?

C. How is the value of an outgoing partner's share determined?

D. *A*, *B*, and *C* are in partnership sharing profits and losses one-half, one-eighth, and three-eighths respectively. *B*, however, has entered into an agreement with his fellow partners whereby his share of the profits must not be less than £411.

The net profits for the current year amount to £2,100. Prepare an account showing the amount due to each partner.

E. S. Blundell and R. Dent are in partnership, and the provisions of the Partnership Deed are that each partner shall be allowed $5\frac{1}{2}\%$ interest on capital, and that profits and losses shall be shared as to four-fifths and one-fifth. On the 1st January, 1940, their capitals were: Blundell, £1,875; and Dent, £375. During 1940, they made a loss of £535 without reckoning interest on capital. Their drawings during the year were: Blundell, £310; and Dent, £175.

Prepare Profit and Loss and Capital Accounts for the year ended 31st December, 1940.

F. In the partnership agreement of Jordan and Slater it is provided, ***inter alia***, that interest at 5% per annum shall be charged on all sums withdrawn by

the partners. In the year ended 31st December, Jordan has drawn £200 at the end of each quarter, and Slater has drawn £50 at the end of each month and an extra £100 on 30th June. Set out the Drawings Accounts in full (monthly calculations of interest) and transfer the balances to their Capital Accounts by means of journal entries.

G. Fairfax Brothers consists of three partners (*A*, *B* and *C*). The capital is held as follows:—*A*, £10,000; *B*, £12,000; and *C*, £7,500. Interest at 5% is allowed upon capital and is charged on drawings, upon which there are no restrictions as to amount or date. *C* is entitled to be credited with a salary of £400 per annum. *B* lent £5,000 to the firm at 6% interest. All the partners withdrew goods from the firm for personal use.

In what form should the partners' accounts be recorded in the books of the firm?

Illustrate your answer by submitting a specimen of each kind of account you recommend the firm to employ.

H. James Neil, who carries on business as an Iron and Steel Merchant, agrees to admit Oscar Anderson into partnership for a term of 10 years, on condition that he introduces £1,000 by way of premium. After six years the partnership is dissolved. Is Anderson entitled to have any portion of his premium returned? State reasons.

I. The firm of *P* & *Q* consisted, on 30th June, of two partners sharing profits in the proportions of four-sevenths and three-sevenths respectively. The Balance Sheet at that date showed:—

Liabilities.	£	*Assets.*	£
Capital A/c.—*P*	8,000	Land and Buildings	3,500
" " *Q*	6,000	Plant and Machinery	5,250
Creditors	7,500	Furniture and Fixtures	800
Profits not drawn	1,400	Stock and Stores	5,700
		Debtors	6,600
		Cash	1,050
	£22,900		£22,900

It is agreed to admit *R* into partnership on 1st July, on payment of £2,100 for goodwill, divisible between *P* and *Q* in the proportions in which they provided capital and divided profits. *R* also brings in £4,000 capital. One-half of the profits not drawn on 30th June are to be withdrawn by *P* and *Q* in their respective proportions, the balance to remain in the business and to be credited in the same proportions to *P* and *Q's* capital accounts. It is agreed that the stock and stores shall be reduced in value to £5,000, and that the reduction shall be charged to the capital accounts of *P* and *Q* in the proportion of four-sevenths and three-sevenths. *P*, *Q*, and *R* are to divide profits in proportion to their respective capital accounts as on 1st July. Show the respective Capital Accounts of the three partners as at that date, and set out the Balance Sheet of the new firm as at 1st July.

J. Harold and Peter Chance agree to admit David Moss, their Manager, into partnership as on 1st January. Interest at 5% is allowed on capital which is as follows:—Harold Chance, £10,000; Peter Chance, £5,000; David Moss, £1,000.

Moss is to be credited with a salary of £300 per annum, £200 of which is to be debited to Harold Chance and £100 to Peter Chance. After providing for interest

on capital the profits are to be divided as follows :—Harold Chance, 4/9ths ; Peter Chance, 3/9ths ; David Moss, 2/9ths. No interest is charged on drawings, which were as follows :—Harold Chance, £1,500 ; Peter Chance, £800 ; David Moss, £400.

At the end of the first year the profit amounted to £5,030 before making any of the above adjustments.

Give the partners' accounts as they would appear in the Balance Sheet as on 31st December.

K. Gauley and Forest are in partnership, and share profits and losses as to two-thirds to Gauley and one-third to Forest. The capital is held as follows : Gauley, £12,000 ; Forest, £6,000. On 31st December, 1940, the credit balances of the partners' current accounts were : Gauley, £1,840 ; Forest, £920.

On 1st January, 1941, the firm admitted Pirrie into partnership on the following terms : Goodwill to be valued at £6,000 and to be credited to the capital accounts of the original partners. The current accounts to be transferred to the capital accounts. Pirrie to bring in, as capital, an amount equal to one-fourth of the total capital of the original partners as adjusted above.

Give the Capital Accounts as they would appear in the initial Balance Sheet of the new firm on 1st January, 1941.

L. On 31st March, the Balance Sheet of *X* and *Y* was as follows :—

Liabilities.	£	£	*Assets.*	£
Sundry Creditors		16,000	Cash at Bank and in hand	2,000
Capital :—			Sundry Debtors . .	8,000
X . .	8,000		Stock in Trade. . .	10,000
Y . .	4,000		Machinery, Fixtures, etc. .	6,000
		12,000	Patents and Patterns .	2,000
		£28,000		£28,000

As from the date of the Balance Sheet *X* and *Y* agree to admit *Z* as a partner, who is to bring in £6,000, one-half of which is to be regarded as a premium, two-thirds of such premium is to be credited to *X* and one-third to *Y* ; he is also to bring in £3,000 as capital, and the profits are subsequently to be divided as to *X* one-half, *Y* one-third, and *Z* one-sixth. Draw up the opening Balance Sheet of the new firm, and show the Capital Accounts of the three partners.

M. Messrs Hunt, Fox, and Barlow were in partnership, and their capitals on the 1st March, 1940, were as follows : Hunt, £3,125 ; Fox, £2,250 ; and Barlow, £2,250. The partners' drawings during the year were : Fox, £175, and Barlow, £175. The trading profit for the year ended 28th February, 1941, amounted to £1,260 12s. 6d. Their Partnership Deed provided that interest at the rate of 5% per annum should be allowed on capital, and that profits and losses should be divisible thus : Hunt, three-sevenths, and Fox and Barlow two-sevenths each.

On the 1st March, 1941, they take Blaize into partnership and agree to give him an eighth share of the profits. In order that he may be entitled to this proportion of the profits *pro rata* with the capital of the other partners as at the 1st March, 1941, what amount must he introduce, and what will then be the proportions for division of profits amongst all the partners ?

N. Ball and Green, who are partners sharing profits and losses as to five-eighths and three-eighths, admit Lane into partnership as from 1st July. The

Partnership Deed provides that Lane shall receive one-fifth of the net profits, after allowing £400 salary and 4% interest on capital for each partner.

One year afterwards it was ascertained that £4,000 net profit had been made before charging partners' salaries, or interest on capital. The capital accounts were as follows: Ball, £6,000; Green, £4,000; and Lane, £1,500.

Prepare Profit and Loss Appropriation Account and Partners' Capital Accounts.

O. Thorley and Rutter are in partnership, with capitals of £6,000 and £3,000 respectively, profits and losses being divided in proportion to their capitals.

On the 31st December they had, in addition to their capitals, undrawn profits amounting to £1,200 (Thorley) and £1,600 (Rutter).

On that date they admit Ashley into partnership on the following terms:

The Goodwill is to be valued at £3,000, which is to be credited to the capital accounts of Thorley and Rutter, and the undrawn profits to the extent of £1,000 each are to be capitalised—the balances of undrawn profits then remaining being withdrawn.

Ashley is to bring in sufficient cash to give him a one-third interest in the business.

State the amount of each partner's capital when these arrangements have been carried through.

P. *A* and *B* are trading in partnership, having capitals of £3,000 and £2,000 respectively, and sharing profits in those proportions. They admit *C* into partnership, on the terms that he shall bring in £1,000 as capital and pay *A* and *B* £500 for his share of the goodwill, the profits to be divided in the proportions of the new capitals. Show what those proportions will be (*a*) if *A* and *B* draw out the £500; and (*b*) if the £500 is left in the business as capital.

Q. *A* and *B*, carrying on business separately in the same trade, agree to enter into partnership, and at the same time it is agreed to admit *C*, who has hitherto acted as *A's* manager. The whole of the assets of *A* and *B*, with the exception of *A's* War Loan investment, are to be brought in, and *C* is to pay £1,000 as goodwill to be credited equally between *A* and *B*.

The Balance Sheets of *A* and *B* were as follows:—

Liabilities.	*A* £	*B* £	*Assets.*	*A* £	*B* £
Creditors	19,000	20,110	Freehold Premises	4,000	
Capital	26,595	23,600	Plant, etc.	3,000	4,500
			Stock	12,000	8,000
			Debtors	23,000	27,000
			War Loan	2,000	
			Bank	1,500	4,000
			Cash	95	210
	£45,595	£43,710		£45,595	£43,710

Open the books of the partnership, and show the adjusted Balance Sheet.

R. Henson and Scanlan were equal partners. Henson died on 30th December. Accounts were prepared at the close of the financial year 31st December, when it was found, after transferring the profit for the year in the ordinary way, that the Partners' Accounts stood as follows: Henson, Capital Account, £8,000; Current Account (Credit Balance), £962. Scanlan, Capital Account, £7,000; Current Account (Credit Balance), £852.

It was agreed with Henson's Executors that the value of the goodwill, which had not hitherto appeared in the books, should be fixed at £3,000, and that the assets and liabilities should be revalued. Valuations were made with the following results: the book value of the Plant and Machinery was reduced by £500; the Reserve for Bad Debts was found to be excessive by £200; the Stock was under-valued by £350; the Sundry Creditors were overstated by £670; and the Patents (book value, £300) were held to be of no value.

Submit the Partners' Accounts as they would appear in the Revaluation Balance Sheet.

S. *R* and *S* are partners as builders and contractors with a capital of £6,000 equally divided. At 31st December, 19.., they owed £780 to sundry creditors; they had owing to them £1,470, they valued their stock at £280, and had a bank balance of £475. In the early days of the partnership they acquired properties at a cost of £8,400, on which they borrowed £3,845, and this sum was still owing in the following January, when *R* died. *S* carried on the business, and sold the properties for £13,000. You are instructed to prepare the accounts as between *S* and the executor of *R*. There was no partnership deed. The profits of the period between 31st December and the date of *R's* death were estimated to be £60.

T. *A* and *B* carry on business as solicitors, in partnership, and share profits and losses equally.

The profits as shown by the books have been :—

	£
Year to 31st December 1936	300
,, ,, 1937	1,000
,, ,, 1938	1,600
,, ,, 1939	3,000
,, ,, 1940	1,800

and have been divided according to the basis given.

The profits have not been accurately ascertained, in that Work in Progress, and Disbursements recoverable, have not been brought into account.

It is agreed that these assets shall be introduced into the books as at 31st December, 1940, and that the apportionment of profits already made shall be adjusted as necessary.

The values of the assets referred to were :—

	Work in Progress. £	Disbursements recoverable. £
31st December 1936	980	120
,, 1937	1,050	250
,, 1938	1,600	300
,, 1939	640	60
,, 1940	1,120	280

Prepare an Adjustment Account showing the true profits for each year, and give the journal entries necessary to bring the figures into the books at 31st December, 1940.

CHAPTER VII

THE TRADING ACCOUNT, PROFIT AND LOSS ACCOUNT AND BALANCE SHEET

It has already been shown that the ultimate object of book-keeping is the preparation and compilation of the Trading and Profit and Loss Accounts and Balance Sheet, to enable the trader to ascertain :—

(1) The result of his business operations during a given period ; and
(2) His financial position at the end of that period.

It has also been explained that, in order to obtain these results accurately, it is necessary to make adjustments for :—

(1) Expenses accrued but not paid and therefore not yet shown in the books.
(2) Expenses paid in advance, a proportion of which is in respect of, and is chargeable to, the next succeeding trading period.
(3) Income due in respect of the current trading period but not yet received.
(4) Income received during the current period but relating to the succeeding period.
(5) Reserves for possible losses, e.g., bad debts, and discounts on debtors.
(6) Necessary adjustments for depreciation in the values of the assets at the end of the trading period.

Examples of simple adjustments of these classes, with the appropriate journal and ledger entries, are given in Chapter IV., on pages 90 to 107, but it will be useful to recapitulate the method of treatment as affecting the Profit and Loss Account and Balance Sheet.

Expenses Accrued.

This will usually include such items as rent, telephone, lighting, heating, etc. Adjustments may also be required for a proportionate part of the employees' weekly wages. The amount which has accrued to the date of balancing is a charge to the debit of Profit and Loss Account, while the double entry

may be completed by showing the same amount as a credit balance in an Outstanding Expenses Account.

The items in the Outstanding Expenses Account may be treated in either of two ways when the books are reopened for the next trading period :—

(1) The items may be left on the credit side of this account, and when the amount is subsequently paid and credited to cash, the debit entry will be divided into two portions. One portion—the amount outstanding at the balancing period—will be debited to this account, thus cancelling the corresponding credit item ; the other portion—the amount accrued since the date of balancing—being debited to the appropriate expense account ; or

(2) The items may be transferred back to the appropriate expense accounts as credit balances ; and when the amount is paid and credited to cash, the debit item will be to the expense account in the ordinary way.

In many cases, however, no Outstanding Expenses Account is opened at all, the outstanding amounts being debited to their respective accounts and carried down as credit balances in the same accounts for the next period. This is the most direct method, and the one which should usually be adopted in working examination exercises. (See *ante*, Chapter IV.)

The amount of accrued expenses will appear as a liability in the Balance Sheet.

Expenses Paid in Advance.

Insurance premiums are always payable in advance ; hence at the end of the trading period there will probably be some unexpired portion of the premium which relates to the future trading period. Rates and taxes may require adjustment in a similar manner.

The amount unexpired is shown in the Profit and Loss Account as a deduction from the appropriate debit item, thus reducing the charge and, in effect, crediting the Profit and Loss Account. The equalising debit is shown by entering the amount paid in advance in an account called " Rates Paid in Advance Account " or some other appropriate name. Alternatively, the necessary adjustment for expenses paid in advance may be made in the respective nominal accounts, the proportion relating to the succeeding period being credited and carried down as a debit balance in the same accounts.

The amount of expenses paid in advance will appear as an asset in the Balance Sheet.

Income Outstanding.

Where income is due in respect of the current trading period but such income has not been received at the date of preparation of the final accounts or where income, although not yet due, has accrued at the date of the final accounts, provision must be made in order that the accounts will show the full amount of income in respect of the period. The necessary adjustment may be effected by crediting the amount accrued, or the amount due but not yet received, to the nominal account, e.g., Rent Receivable or Interest Receivable, and debiting the same amount to a special Income Outstanding Account, or carrying down the amount accrued or outstanding as a debit balance on the nominal amount concerned. These entries will have the effect of increasing the amount of income transferred to the credit of Profit and Loss Account while the debit entry will appear as an asset in the Balance Sheet.

Income Received in Advance.

In certain cases it may be found that some of the income received during the current trading period relates to the succeeding trading period, e.g., rent of sub-let premises received in advance. The appropriate adjustment can be effected in a reverse manner to that set out in the preceding paragraph, thus decreasing the amount of income transferred to the credit of Profit and Loss Account. The credit entry in the nominal account concerned, or the entry in a special Income Received in Advance Account will appear as a liability in the Balance Sheet.

Reserves for Possible Losses and Gains.

It is only fair that each year's trading period should bear the losses and benefit by the gains attributable to that year's trading, but in some cases these losses and gains will not be known until a much later date. Accordingly, reserves are made for such estimated amounts as past experience and knowledge of the business indicate to be necessary.

Reserves for bad debts and discounts on debtors are provided for by debiting the Profit and Loss Account with, usually, a percentage on the debtors outstanding at the date of balancing (or the amount required to bring the existing reserves up to such percentage), while the credit entries are made in accounts headed "Reserve for Bad Debts" and "Reserve for Discounts Allowable," respectively. Alternatively, these reserves may be carried down to the new period as credit balances on Bad Debts and Discount Allowable Accounts. Where both reserves are made, the Reserve for Discounts Allowable is usually calculated on the outstanding debtors *after* deduction of the Reserve for Bad Debts. Possible gains—such as discounts allowed by creditors on amounts to be paid to them—are dealt with in a similar way; the amount reserved, usually a percentage on creditors outstanding, being

credited to Profit and Loss Account, and debited to an appropriate "Reserve for Discounts Receivable Account" which is opened in the General Ledger, or, alternatively, carried down as a debit balance on Discount Receivable Account. These reserves are shown in the Balance Sheet as deductions from "Sundry Debtors" and "Sundry Creditors" respectively.

Entry of Adjustments in the Final Accounts.

It will be realised that, in practice, the above-mentioned adjustments are made in the appropriate ledger accounts before the Profit and Loss Account is prepared, and that only the final balances of the nominal accounts are transferred to the Profit and Loss Account.

In examination papers, however, candidates are usually given a Trial Balance showing the position before the adjustments are entered in the books; particulars of the adjustments being appended. These adjustments should be added to (or deducted from, as the case may be) the trial balance figures, only the final totals being extended to the Profit and Loss Account, although details may be shown in an inner column as in the following example :—

		£	£
To Rent, Rates and Taxes		250	
Add rent accrued		40	
		290	
Less rates paid in advance . .		25	
			265

Care must, of course, be exercised to see that the equalising contra entries are made in the Balance Sheet. In the above example, "rent accrued" will appear as a liability and "rates paid in advance" as an asset.

Valuation of Assets.

The basis of valuation of assets will depend upon their nature, i.e., whether they are fixed or floating.

Fixed assets are those which are of a more or less permanent nature, and are acquired for the purpose of enabling a trader to carry on his business, e.g., plant, machinery, and buildings; with this class of asset the general rule is to value them at cost, less an allowance for depreciation sufficient to reduce the book-value of the asset to its scrap value by the end of its working life.

Fluctuations in the values of fixed assets, such as plant and machinery, are not generally provided for in calculating the profit

of a business, as such fluctuations are caused by outside factors which in no way affect either the earning capacity or the usefulness of such assets to the business as a going concern.

FLOATING ASSETS are those which are obtained and held, not as agents of production, but for the purpose of subsequent conversion into cash ; they are therefore not of a fixed, permanent nature, but are continually changing in the ordinary course of business. The most common examples of floating assets are cash, book debts, stock-in-trade, and bills receivable. The broad basis of valuation of floating assets is "cost price or market value, whichever is the lower," though this rule is subject to exceptions, which are not, however, of sufficient importance to be dealt with in a work of this nature. The fundamental reason for this basis of valuation is that anticipated losses should always be provided for as far as possible, while anticipated profits should be ignored until actually realised. For example, suppose in one trading period 100 gross knives are purchased at 2s. 6d. each ; and at the close of the period, none having been sold, the market price has fallen to 2s. each. The new period (considered as a separate business) could buy these knives at 2s. each in the open market ; and the anticipated loss on the sale of this stock should be provided for by reducing the value of the stock in the books to market value, i.e., 2s. each. Had the price risen to 3s., the knives would be valued at the lower price, i.e., cost, for, although there is a possibility of an enhanced profit, it is equally possible that the price may have fallen again before the knives are actually sold.

Although examples of fixed and floating assets are given above, it must not be supposed that it is possible to divide assets into these classes with any degree of certainty ; what is a fixed asset in one business may be a floating asset in another, and any classification must depend upon the nature of the particular business carried on by the trader or firm. Thus, to a firm of furniture dealers a motor van is a fixed asset and furniture is a floating asset, while to a firm trading in motors a motor van is a floating asset and office furniture is a fixed asset. Numerous other examples will occur to the reader—e.g., land and buildings are floating assets to a dealer in real estates, and fixed assets to a manufacturer.

Valuation of Book Debts and Investments.

The present value of book debts (i.e., the amounts owing by sundry debtors) is adjusted by means of Reserves for Bad Debts and for Discounts, as may be required.

Investments, however, may be either "fixed" or "floating" assets, according to the nature of the business and the purpose for which the investments are held; but if they are considered to be floating assets, they should be valued in the same manner as

stock-in-trade, viz., at cost or market price, whichever is the lower. An alternative method, which is often adopted, is the creation by means of periodical transfers from Profit and Loss Account of an Investment Reserve Account to cover any probable permanent depreciation in value, temporary fluctuations in value being ignored. This reserve account is shown on the " Liabilities " side of the Balance Sheet, while the investments are shown among the assets at their cost price, a note being appended to indicate their current market value.

The book value of investments, less the reserve, should not ordinarily be greater than the market value at the date of the Balance Sheet, but it is contended by certain authorities that if the investments are fulfilling their normal function of earning revenue as fixed assets, they may be retained in the Balance Sheet at cost. In such circumstances it is most desirable that a note of the current market value be appended.

Valuation of Stock-in-Trade.

For Finished Stock, the general rule is to value at cost or market price, whichever is the lower. The only occasion upon which it is permissible to value stocks above cost is where such stock increases in value with the passage of time, e.g., timber, wines, etc., which mature with age. In such cases stocks are, in practice, frequently valued at cost plus interest thereon at, say, 5 per cent. per annum ; but where this method is adopted, the value should never exceed that at which similar stocks could be purchased in the open market. The correct valuation of stock at the close of the trading period is most important, as upon the accuracy of this valuation will depend the accuracy of the gross profit shown in the Trading Account, and consequently of the net profit given in the Profit and Loss Account. Moreover, it is necessary that both aspects of any transaction relating to stock (the liability as well as the asset) be taken into account in the same trading period ; obviously, if goods received during the last few days of a trading period are included in the closing stock credited to Trading Account but the invoice is not entered in the Purchases Book until the beginning of the next period, the gross and the net profit would be inflated by the amount of that invoice.

It is, therefore, essential that invoices for all goods received during a trading period are properly passed through the Purchases Book during that period. Where an invoice cannot be obtained (e.g., for goods received from abroad) an estimated amount must be passed through the books to cover the liability. Conversely, where goods have been purchased and the invoice entered in the books, but the goods have not yet been delivered, they should be included in stock at cost.

Similarly, all goods sold and delivered during the same period must be charged out to the customer through the Sales Day Book. It sometimes occurs, however, that goods sold during one trading period are not delivered until the next period. Two diverse methods of dealing with such transactions are met with in practice, viz. :—

(*a*) The goods are debited to the debtor through the Sales Day Book and credited to the Sales Account at the time of sale. In this case, the goods must not be included in the stock on hand at the close of the trading period.

(*b*) The goods are not charged out to the customer until delivery is effected; in this case the goods are properly included in the stock on hand at their cost price, but no entry is made in the Sales Day Book in respect of the sale.

It is sometimes difficult to determine which method should be adopted, but the circumstances of each individual case must receive consideration. From a legal view-point, where it is the intention of the parties that the property in the goods (i.e., the absolute right of ownership) passes to the buyer at the time of sale, the first method may be correctly adopted, since the goods are the customer's property. But where it is the intention that the ownership of the goods shall not pass until delivery is effected, the second method is the right one to pursue.

It may seem almost superfluous to add that only the trader's own property should be included in stock on hand, but where a trader customarily handles goods as agent for others, or receives goods on consignment, the warning is not out of place. In accordance with the same rule, where a trader sends out goods on consignment, any unsold portion held by his consignees must be included as his stock-in-hand, as well as stock in the hands of agents and goods temporarily lodged in bond, or in docks, warehouses, etc. (See *post*, Chapter X.)

Obsolete and unsaleable stock, and damaged goods (if any), must be entered at a suitable valuation, whilst goods sent out "on approval," or "on sale or return," should be brought in at cost or market price, whichever is the lower, in the normal manner, as indicated above.

Valuation of Goods on Sale or Return.

In this connection the student is referred to the paragraph in Chapter II on the Goods on Sale or Return Book; the value of such a book will now become apparent.

If goods "on approval" or "on sale or return" are passed through the Sales Day Book and charged out to the prospective buyers, returns being recorded by a credit note, it will be seen that the tracing of goods still on approval will be difficult and

tedious and accompanied by grave risks of entries being passed over, with consequent inaccuracies. The system adopted in practice, where goods are so charged out, is to forward to the prospective purchaser a *pro formâ* invoice, a copy of which is placed in a special file marked "Goods on Approval," to be removed when the goods are finally accepted or returned. Although this system is theoretically adequate, and enables the quantity of goods on approval to be ascertained by inspection of the *pro formâ* invoices in the file at the date of closing the accounts, it will not commend itself to the modern accountant by reason of the numerous steps involved, with the additional labour and risk of error attached to each.

It will thus be seen that the use of a "Goods on Sale or Return" book is actually a simplification, rather than an additional complication, of the book-keeping; and both for this reason and because of the advantages outlined in Chapter II, this book should always be used in practice.

Valuation of Work-in-Progress.

Work-in-Progress must be carefully distinguished from Finished Stock-in-Trade. In a manufacturing concern it represents goods which are partly manufactured at the date of the Balance Sheet, and it should be recorded in a separate account in the ledger.

Work-in-progress at the commencement of the trading period should be debited, and that at the end of the trading period credited to the Trading Account [or to the Manufacturing Account (see page 250) where such an account is kept], in the same manner as finished stock-in-trade.

The valuation to be placed upon work-in-progress differs somewhat from that of finished stock, and it is necessary to determine the amount of raw material, labour, and other expenses which can be directly charged to the cost of its manufacture. A reasonable charge should be added to cover overhead expenses, but on no account should any estimate for profit be included except in the circumstances stated later in Chapter XVI. Where, owing to violent fluctuations in market conditions, the selling price of the finished article has fallen considerably, it should be seen that the value placed upon work-in-progress does not exceed the market price. In the case of non-manufacturing concerns the item may represent partly completed orders.

Cash received on account of work-in-progress should be shown as a deduction from the latter in the Balance Sheet. This item most frequently arises in the accounts of contractors, and represents cash paid by customers on account of partly finished contracts which would be included in work-in-progress. No debits are usually made in the customers' personal accounts until the contracts are completed, when sales will be credited with the full

amount of the contracts. Alternatively, the customers' personal account are debited with the value of the work certified as completed to date and credited with the cash paid to date. This matter is dealt with in more detail in Chapter XVI.

Valuation of Stores-in-Hand.

Stores-in-hand denote those materials which are used in connection with the upkeep and maintenance of plant and machinery and other assets employed in the process of manufacture, e.g., fuel, oils, cleaning materials, packing materials, etc. The item should be valued separately and not included with the general stock-in-trade. By this means it is ensured that the amount charged against revenue will represent the actual value consumed during the trading period, the amount of the valuation being credited to the expenditure account and brought down as a balance.

The term "Stores" is sometimes used to denote raw materials on hand, as distinct from the term "Stock," the use of which is sometimes confined to finished goods.

Capital and Revenue Expenditure.

The distinction between Capital and Revenue expenditure is extremely important, because the former results in, or is due to, the acquisition of assets which must appear in the Balance Sheet, while the latter represents the expenses incurred in the business, and is debited to the Trading or Profit and Loss Accounts.

When expenditure results in the acquisition of a permanent asset, or in the permanent improvement of, or the addition to, or the extension of an existing asset, which is capable of, and intended for, repeated or continuous use in the earning of profits or revenue, it is capital expenditure. An example is the purchase price of machinery with which a manufacturer converts raw material into a saleable product.

All expenditure which cannot properly be debited to an asset account is revenue expenditure. This includes, in the case of a manufacturing business :—

(*a*) The cost of materials purchased for consumption in the process of manufacture, or of goods bought for re-sale.

(*b*) Wages paid to workmen engaged in the production of commodities for sale.

(*c*) The expenses of selling and distributing the goods produced.

(*d*) Establishment charges, such as office salaries, rent, interest, etc.

(*e*) The cost of using the permanent assets of the business, and of maintaining their efficiency by means of repairs, renewals and replacements.

The Adjustment of Capital and Revenue Expenditure.

With manufacturing businesses, particularly engineering and allied undertakings, employees are occasionally engaged, and materials used, in the permanent improvement or erection of buildings and plant. In such cases it is necessary to debit the wages paid and materials used to the asset accounts concerned, and it is not incorrect to add to the direct cost a proportion of the indirect expenditure involved in the supervision of the work, e.g., foremen's wages, etc., although it is prudent to ignore the expense under the latter heading or to calculate it upon a very conservative basis.

If an analysis of wages and materials is not available for the purpose of ascertaining the current expenditure chargeable to capital, the value of the wages paid and materials used on the extensions, etc., must be estimated by a responsible official at the end of the financial year, and a journal entry made to adjust the charges to capital and revenue as illustrated in the following example :—

EXAMPLE.

At the end of a firm's financial year the Trial Balance included, *inter alia*, the following items :—

	£
Purchases	6,750
Purchases Returns	500
Sales	15,400
Sales Returns	150
Stock at beginning of year	8,100
Wages	5,400

The stock at the end of the year was valued at £9,000.

During the year the firm had extended their factory, which was valued in the books at £10,000. The extensions had been undertaken by the firm's own workmen, who had used materials taken from the general stock. It was estimated that the wages paid in connection with the extensions amounted to £600 and the materials used from stock were valued at £400.

Make, by journal entries, the necessary adjustments in connection with the extensions, and show the Factory Premises Account and the Trading Account for the year. Ignore depreciation.

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			£	£
19..				
Dec. 31	Factory Premises Account . . . . *Dr.*		1,000	
	To Wages			600
	,, Purchases			400
	Being transfer of materials and wages in respect of the factory extension.			

Dr. FACTORY PREMISES ACCOUNT. Cr.

19..			£	19..			£
Jan. 1	To Balance .	b/d.	10,000	Dec. 31	By Balance .	c/d.	11,000
Dec. 31	" Wages .		600				
	" Purchases .		400				
			£11,000				£11,000
19..							
Jan. 1	To Balance .	b/d.	11,000				

NOTE.—The balance of this account (£11,000) will appear in the Balance Sheet as an asset.

TRADING ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. Cr.

	£	£		£	£
To Stock at 1st Jan. 19.. . . .		8,100	By Sales . . .	15,400	
" Purchases . .	6,350		*Less* Returns .	150	15,250
Less Returns .	500	5,850	" Stock at 31st Dec. 19.. .		9,000
" Wages . .		4,800			
" Balance, being Gross Profit transferred to Profit and Loss Account . .		5,500			
		£24,250			£24,250

Deferred Revenue Expenditure.

In the early years of a business it may be necessary to spend a considerable sum in advertising and other publicity work. There is usually a "lag" between the expenditure and the income which it produces. In such cases it is proper to charge only a part of the total cost of such publicity to the current year's Profit and Loss Account, and to carry the balance forward as deferred revenue expenditure which will be charged to revenue by degrees over the period during which benefit is expected to be derived from it.

Extraordinary Revenue Expenditure.

These are items which are not repeated annually, e.g., heavy repairs and renewals to plant and machinery at fairly long intervals, say, three or four years. It would be unfair to charge the whole of the cost of the repairs and renewals to the period in which the repairs are effected, because the revenues of preceding years are benefited by the wear and tear now made good.

The recurrent expenditure should preferably be provided for by the creation of a Maintenance Reserve Account (or Repairs

and Renewals Reserve Account), a sum equal to one-third (where the repairs are necessary every three years) of the cost of such repairs and replacements being charged annually to Profit and Loss Account and credited to the Maintenance Reserve Account, to which the expenditure will be debited as and when incurred.

The adoption of this method will equalise the charge over the periods, will enable the true profits to be shown in each period, and will stabilise the profit, so far as it is affected by this kind of fluctuation. As it is important that the necessary cash should be available at the time the repairs are effected, it is advisable that the profits thus set aside should be earmarked either by placing cash on deposit at the bank or by an investment in gilt-edged securities.

ADJUSTMENTS FOR DEPRECIATION

The main methods of adjusting the depreciation charged on wasting assets are six in number, namely :—

1. Fixed Instalment Method.
2. Reducing Instalment Method.
3. Depreciation Sinking Fund.
4. Endowment Insurance Policy.
5. Revaluation Method.
6. Annuity Method.

Other methods which are not so frequently encountered are :—

1. Depreciation Reserve Method.
2. Depletion Unit Method.
3. Efficiency Hour Method.

The first two methods have been described and fully dealt with in Chapter IV, pages 93 to 98.

Depreciation Sinking Fund.

By this method the annual charge for depreciation, as ascertained from interest tables, is debited to the Profit and Loss Account, and credited to a " Depreciation Sinking Fund Account." An equivalent amount is withdrawn from cash and invested in gilt-edged securities, the interest thereon as and when received being credited to the Fund Account and invested with the next instalment.

Under this system, the asset remains at the original cost in the Balance Sheet, while the Depreciation Sinking Fund is shown as a liability and the Investment Account as an asset. At the end of the life of the asset the investments are sold and the asset may be replaced out of the proceeds without any forced realisation or disturbance of the other assets.

The old asset account is closed by a transfer from the Depreciation Sinking Fund Account, and any small credit balance remaining in the latter account may be left to start a new sinking fund in respect of the new asset, any debit balance being written off to Profit and Loss Account.

EXAMPLE.

A five years' lease of premises is purchased for £4,333 and depreciation is provided for by means of a sinking fund of five annual instalments of £800 which are invested at 4% compound interest. Show the relative ledger accounts duly entered up.

Dr. LEASE ACCOUNT. *Cr.*

			£	s.	d.				£	s.	d.
1st year	To Cash		4,333	0	0	5th year	By Depreciation Sinking Fund		4,333	0	0

Dr. DEPRECIATION SINKING FUND ACCOUNT. *Cr.*

			£	s.	d.				£	s.	d.
2nd year	To Balance	c/d.	1,632	0	0	1st year	By Profit and Loss Account		800	0	0
						2nd ,,	,, Cash (Interest)		32	0	0
						,, ,,	,, Profit and Loss Account		800	0	0
			£1,632	0	0				£1,632	0	0
3rd year	To Balance	c/d.	2,497	5	7	2nd year	By Balance	b/d.	1,632	0	0
						3rd ,,	,, Cash (Interest)		65	5	7
						,, ,,	,, Profit and Loss Account		800	0	0
			£2,497	5	7				£2,497	5	7
4th year	To Balance	c/d.	3,397	3	5	3rd year	By Balance	b/d.	2,497	5	7
						4th ,,	,, Cash (Interest)		99	17	10
						,, ,,	,, Profit and Loss Account		800	0	0
			£3,397	3	5				£3,397	3	5
5th year	To Lease Account		4,333	0	0	4th year	By Balance	b/d.	3,397	3	5
,, ,,	,, Balance	c/d.		1	3	5th ,,	,, Cash (Interest)		135	17	10
						,, ,,	,, Profit and Loss Account		800	0	0
			£4,333	1	3				£4,333	1	3
						5th year	By Balance	b/d.		1	3

Dr. INVESTMENT ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
1st year	To Cash . .		800 0 0	2nd year	By Balance . .	*c/d.*	1,632 0 0
2nd "	" " (Interest and Instalment) .		832 0 0				
			£1,632 0 0				£1,632 0 0
2nd year	To Balance . .	*b/d.*	1,632 0 0	3rd year	By Balance . .	*c/d.*	2,497 5 7
3rd "	" Cash (Interest and Instalment) .		865 5 7				
			£2,497 5 7				£2,497 5 7
3rd year	To Balance . .	*b/d.*	2,497 5 7	4th year	By Balance . .	*c/d.*	3,397 3 5
4th "	" Cash (Interest and Instalment) .		899 17 10				
			£3,397 3 5				£3,397 3 5
4th year	To Balance . .	*b/d.*	3,397 3 5	5th year	By Balance . .	*c/d.*	4,333 1 3
5th "	" Cash (Interest and Instalment) .		935 17 10				
			£4,333 1 3				£4,333 1 3
5th year	To Balance . .	*b/d.*	4,333 1 3	6th year	By Cash . .		4,333 1 3

Dr. NEW LEASE ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
6th year	To Cash . .		4,333 0 0				

NOTES.—(1) In the foregoing example income tax is ignored, and it is assumed that the instalments and interest are invested at par; also that, at maturity, the investments are realised at par. In actual experience, however, it is found that the investments realise either more or less than the amounts originally invested, according to the nature of the investments selected and the state of the stock markets.

(2) In practice, the last instalment and interest (£935 17s. 10d.) would not be invested, as the money is required for the purchase of the new lease on the date when this investment should be made.

(3) The credit balance of 1s. 3d. on Depreciation Fund Account arises through (i) the annual instalments of £800 being slightly in excess of the amounts actually required to be invested in order to provide £4,333 in 5 years and (ii) calculations of interest being approximated to the nearest 1d. This balance can be either transferred to Profit and Loss Account or it can be utilised to open the Depreciation Fund Account in respect of the new lease.

Endowment Insurance Policy.

This method is similar in effect to that by which a Depreciation Sinking Fund is raised, but instead of investing the amount

set aside each year in gilt-edged securities, the money is used in payment of the premium on a "pure endowment" policy which will mature at the end of the period, when the asset will have to be replaced. The annual charge, as represented by the premium, will be greater than that under the Depreciation Sinking Fund method, because the insurance company will necessarily require to make a profit out of the transaction in addition to paying their own expenses. On the other hand, the full amount of the policy will be received at its maturity, and there is with this method no risk of loss on realisation of securities which sometimes occurs with the investment method.

Assuming that an annual premium of £820 is required to assure the payment of £4,300 in five years' time, the entries required annually will be :—

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			Dr.	*Cr.*
19..			£	£
Dec. 31	Insurance Policy Account . . . . *Dr.*		820	
	To Cash			820
	Being payment of premium.			
Dec. 31	Profit and Loss Account . . . . *Dr.*		820	
	To Lease Redemption Account . . .			820
	Being amount chargeable against profits for lease redemption.			

The Lease Redemption Account will appear as a liability and the Insurance Policy Account as an asset in successive balance sheets, whilst the Lease Account remains at its original cost. At the maturity of the policy, an adjusting entry will be required to raise the redemption and policy accounts to the full amount of the policy, as follows :—

19..			£	£
	Insurance Policy Account . . . . *Dr.*		200	
	To Lease Redemption Account . . .			200
	Being difference between total premiums paid and the amount receivable from insurance company.			

The ledger accounts will appear as follows :—

Dr. LEASE ACCOUNT. *Cr.*

			£				£
1st year	To Cash . .		4,300	5th year	By Lease Redemption Account		4,300

Dr. LEASE REDEMPTION ACCOUNT. *Cr.*

			£				£
5th year	To Lease Account		4,300	1st year	By Profit and Loss Account .		820
				2nd ,,	,, ,, ,,		820
				3rd ,,	,, ,, ,,		820
				4th ,,	,, ,, ,,		820
				5th ,,	,, ,, ,,		820
				,, ,,	,, Insurance Policy Account .		200
			£4,300				£4,300

Dr. INSURANCE POLICY ACCOUNT. *Cr.*

			£				£
1st year	To Cash . .		820	5th year	By Cash . .		4,300
2nd ,,	,, ,, . .		820				
3rd ,,	,, ,, . .		820				
4th ,,	,, ,, . .		820				
5th ,,	,, ,, . .		820				
,, ,,	,, Lease Redemption Account		200				
			£4,300				£4,300

At the expiry of the lease, the Lease Account is closed by a transfer from the Redemption Account, and when the amount of the policy is received from the insurance company, Cash is debited and the Policy Account credited, the money thus being available for the renewal of the lease or for the purchase of a new one.

In certain cases the Policy Account is debited with compound interest, the corresponding credit appearing in the Redemption Account. The policy then appears in the Balance Sheet as an investment accumulating at interest in the same way as in the sinking fund method previously described.

An alternative method which is sometimes adopted is to maintain the Policy Account at its surrender value, i.e., the amount which the insurance company will pay in the event of the policy being cancelled. The insurance company will usually supply information as to the surrender value on request, and this amount is carried down as a debit balance on Policy Account, the difference between this figure and the premiums debited thereto being transferred to Redemption Account.

Assuming that, as in the previous example, an annual premium of £820 is paid and that the surrender values for the first two

years were £100 and £800, the Policy and Redemption Accounts for these years will be :—

Dr. INSURANCE POLICY ACCOUNT. *Cr.*

			£				£
1st year	To Cash . .		820	1st year	By Lease Redemption Account		720
				" "	" Balance .	c/d	100
			£820				£820
2nd year	To Balance. .	b/d	100	2nd year	By Lease Redemption Account		120
" "	" Cash . .		820	" "	" Balance. .	c/d	800
			£920				£920
3rd year	To Balance. .	b/d	800				

Dr. LEASE REDEMPTION ACCOUNT. *Cr.*

			£				£
1st year	To Insurance Policy Account .		720	1st year	By Profit and Loss Account .		820
" "	" Balance. .	c/d	100				
			£820				£820
2nd year	To Insurance Policy Account .		120	2nd year	By Balance .	b/d	100
" "	" Balance. .	c/d	800	" "	" Profit and Loss Account .		820
			£920				£920
				3rd year	By Balance .	b/d	800

When the policy money is received, the book entries will be similar to those in the example on pages 230 and 231, except that the final transfer from Insurance Policy Account to Lease Redemption Account will necessarily be for a different sum.

Revaluation Method.

With certain assets, such as loose tools, farmers' live stock, cattle and horses, etc., depreciation cannot be estimated accurately by any fixed rule, and accordingly it is necessary to revalue the assets at the end of each trading period. Any loss ascertained is debited to Profit and Loss Account and credited to the respective asset accounts involved.

Occasionally, the revaluation discloses an appreciation in value of an asset. When such appreciation is due to revenue expenditure, as, for example, in an engineering business where the loose tools are made by the employees in the ordinary course of their duties, the best method is to treat the loose tools in

the same manner as stock-in-trade. The commencing value is transferred to the debit of the Trading Account, while the closing value is entered to the credit of the same account; the contra entries appearing, in each instance, in the asset account; but where the appreciation is due to some cause other than revenue expenditure, e.g., a rise in the value of horses, the increase is of a capital nature. In such cases the appreciation disclosed should either be ignored, or be debited to the asset account and credited to a Capital Reserve Account, which is not available for transfer to Profit and Loss Account.

The Annuity Method.

By this method it is assumed that the capital sunk in the purchase of the asset might, if otherwise expended, have earned a certain rate of interest. Interest on the diminishing balance is accordingly debited to the account of the asset, and a fixed annual charge for depreciation is credited thereto; the balance of the account being completely extinguished (or reduced to scrap value) at the end of the life of the asset.

EXAMPLE.

A five years' lease of premises costs £2,000 and it is decided to charge depreciation by the annuity method, interest being calculated at 5% per annum. Show the Lease Account for the five years, assuming that the annual charge for depreciation amounts to £461 19s. 0d.

Dr. LEASE ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
1st year	To Cash		2,000 0 0	1st year	By Depreciation		461 19 0
" "	" Interest at 5% per annum		100 0 0	" "	" Balance	*c/d.*	1,638 1 0
			£2,100 0 0				£2,100 0 0
2nd year	To Balance	*b/d.*	1,638 1 0	2nd year	By Depreciation		461 19 0
" "	" Interest at 5% per annum		81 18 0	" "	" Balance	*c/d.*	1,258 0 0
			£1,719 19 0				£1,719 19 0
3rd year	To Balance	*b/d.*	1,258 0 0	3rd year	By Depreciation		461 19 0
" "	" Interest at 5% per annum		62 18 0	" "	" Balance	*c/d.*	858 19 0
			£1,320 18 0				£1,320 18 0
4th year	To Balance	*b/d.*	858 19 0	4th year	By Depreciation		461 19 0
" "	" Interest at 5% per annum		42 19 0	" "	" Balance	*c/d.*	439 19 0
			£901 18 0				£901 18 0
5th year	To Balance	*b/d.*	439 19 0	5th year	By Depreciation		461 19 0
" "	" Interest at 5% per annum		22 0 0				
			£461 19 0				£461 19 0

It will be observed that the annual charge for depreciation remains constant, while the interest, which is debited to the Asset Account and credited to Interest Account, gradually decreases as the value of the asset is reduced, thereby involving a gradually increasing net charge against revenue. At first glance, it would therefore appear that the annuity method of depreciation penalises the later years of the life of an asset, but this apparent effect is counterbalanced by the fact that the sums provided as depreciation and retained within the business are earning income.

The annuity method is very suitable for long leases and for similar assets costing a considerable amount of money, and the working lives of which can be accurately calculated at the outset. The amount to be written off annually is calculated by means of depreciation tables.

Depreciation Reserve Method.

Under this method the assets are retained in the Balance Sheet at their original cost, all expenses for repairs and small renewals being charged in the usual way to the Profit and Loss Account for the year in which they occur.

Depreciation is provided for by annual transfers from the Profit and Loss Account to the credit of a Depreciation Reserve Account, which may appear as a liability in the Balance Sheet. It is advisable, however, to show the asset net, by deducting the credit balance on the reserve account from the value of the asset in the Balance Sheet. A single Depreciation Reserve is sometimes created against two or more classes of assets, but this method is not a satisfactory one, since it does not show how much depreciation has been written off each class of asset.

When the worn-out or useless asset is replaced, the cost of replacement, less the realised scrap value of the old asset, is charged to the Depreciation Reserve Account, care being taken to see that the value of the new asset is at least equal to the book value of the old asset.

When the cost of replacing an asset is greater than that of the asset which has been replaced—e.g., when a three-ton lorry which cost £500 is replaced by a five-ton vehicle costing £650—there is, in effect, both an addition and a replacement. In such a case the entire cost of the new asset is frequently debited to the Depreciation Reserve Account, the asset account remaining at the original figure, so that the increase in value forms a secret reserve ; it is, however, perfectly correct to debit the increase to the asset account, only the balance (i.e., cost of the old asset less the realised scrap value) being debited to the Depreciation Reserve Account.

Depletion Unit Method.

When any of the methods considered above are used, it is tacitly assumed that depreciation is suffered in proportion to

the number of years expired out of the total estimated life. This is not always the case and the depletion unit method, which is sometimes used in the case of assets of a wasting nature (e.g., mines, quarries, etc.), takes into account the estimated total contents of the asset. Under this method the price paid for every unit extracted is found (total cost divided by estimated total contents) and such amount written off the total cost of the asset at each accounting period, according to the number of units extracted during that period.

EXAMPLE.

A mine of an estimated total contents of 100,000 tons is bought outright for £10,000. Therefore the cost per ton is 2s. 0d. If, during the first year, 7,000 tons are extracted, the amount to be written off as depreciation for that period is :—

$$7{,}000 \times 2s.\ 0d. = £700.$$

It will be appreciated that owing to the total contents of a mine being an estimated figure, when the mine is finally exhausted there may be a small balance remaining on the Mine Account. Such balance will have to be written off. If the Mine Account is written off prior to its being exhausted no such adjustment will be necessary.

If the mine is acquired under a lease, the term of the lease must be taken into account, and the amount written off in any year must not be less than a proportionate amount of the cost of the lease.

If the contents of the mine are regarded as possessing some of the qualities of stock-in-trade, the equity of this method may be appreciated more readily.

The depletion unit method breaks down if it is not possible to obtain a reliable estimate of the contents of the mine when purchased (or leased).

When providing for depreciation under this method it is necessary to bear in mind that it is not always *profitable* (as distinct from possible) to work a mine to exhaustion. The original estimate of contents should therefore be based on that proportion of the total contents that can reasonably be expected to prove profitable. Such an estimate may be extremely difficult to make, particularly where, as in the case of a gold mine, the possibility of profit is dependent on two variable quantities, i.e.—

(*a*) The cost of recovering the metal (which varies according to the nature and richness of the deposits), and
(*b*) The market price of the product.

Efficiency Hour Method.

This is computed on a similar basis to the depletion unit method, but has regard to the estimated total running hours of a machine during its lifetime as compared with the total contents of a mine. The system is used for computing the depreciation of machinery and plant by reference to the total number of hours

during which it has been in use during the period and is particularly useful in cases where considerable variations in working hours are experienced.

With this method as with the depletion unit method there is a danger in slack periods, for idle plant depreciates then at some, even if a lower, rate, and there is a very real danger that the method might lead to a most inadequate debit in certain years. On the other hand it has considerable advantages in connection with the preparation of cost accounts (see Chapter XVI.), in which it is essential that the charge for depreciation should represent the actual benefit obtained by the use of the machine.

THE FUNCTION OF THE TRIAL BALANCE

The first step in the preparation of the final accounts is the compilation of a Trial Balance, with a view to (*a*) proving the accuracy of the postings, and (*b*) providing in one statement a concise summary of the items which are to be included in the Trading Account, Profit and Loss Account and Balance Sheet.

Debit balances shown in the Trial Balance represent either (*a*) assets, or (*b*) losses and expenses; the former being shown on the right-hand side of the Balance Sheet, while the latter are debited either to the Trading Account or to the Profit and Loss Account. Similarly, the credit balances represent (*a*) liabilities and reserves, or (*b*) income and gains; the former being entered on the left-hand side, or (in certain cases) as deductions from items on the right-hand side, of the Balance Sheet, while the latter are credited either to the Trading Account or to the Profit and Loss Account.

It is, of course, essential to distinguish carefully between balances which appear in the Trading and Profit and Loss Accounts and those which appear in the Balance Sheet, and the following rule should be applied. If any value remains in the business to represent a debit balance (e.g., the balance on Plant and Machinery Account), such balance will appear in the Balance Sheet. If not, it must be a loss or an expense to be "written off" by transfer to the Trading Account or Profit and Loss Account. With regard to credit balances, the question arises, "Is the business under an obligation to refund the value to an outside party (including the proprietor)?" A negative answer indicates a gain or profit to be transferred to the credit side of the Trading Account or Profit and Loss Account. An affirmative answer indicates a liability to be shown in the Balance Sheet.

The Detection of Errors disclosed by the Trial Balance.

When the totals of the Trial Balance disagree, it is obvious that an error or errors have occurred either in—

1. The postings to the ledger;
2. The additions in the subsidiary books or ledger;
3. The balances brought down in the ledger;
4. The extraction of the balances; or
5. The additions of the Trial Balance.

The steps taken to locate the error will depend, to some extent, upon the amount of the difference, but the first step is to check the Trial Balance itself.

If the difference is a round sum, e.g., £10 or £1, it is likely to have arisen through an error in an addition. The casts of the Trial Balance, day books, cash book and ledger accounts should be checked in the order stated. Again, the error may have arisen through a badly-aligned figure which results in an incorrect addition.

A debit included in the Trial Balance as a credit, or *vice versa*, will naturally result in the totals disagreeing, and a search should be made for an error of this class. Where the error is exactly divisible by two, any amounts of half the error should be examined to ascertain whether the item has been placed in the wrong column. Similarly, any items of that amount in the subsidiary books or the ledger should be scrutinised to see whether they have been debited (or credited) twice in error.

The amount of the difference should be thoughtfully considered to trace such an error as £17 10s. posted or carried forward as 17s. 10d., when the Trial Balance would be wrong to the extent of £16 12s. 2d. In the same way, a difference of £38 0s. 9d. would probably be an item of £42 3s. entered as £4 2s. 3d.

The Trial Balance should be compared with the previous one to trace an item (e.g., Petty Cash Book balance) omitted.

The subsidiary books should be inspected to trace an unposted item (without a folio), and it should be seen that the totals of the daybooks, returns books, billbooks, etc., are posted to the private ledger.

If it is possible to balance the ledgers separately, as will be explained in Chapter XI, this should be done; otherwise the sales and purchases ledger balances should be checked, and afterwards the postings to the impersonal ledger and personal ledgers called over and ticked.

The location of errors in balancing is sometimes a most difficult task, but it is always possible to find the difference in a Trial Balance, if sufficient time and trouble are expended. The labour, however, can often be greatly reduced if the person searching is well acquainted with the books and uses his intelligence at every stage.

When working exercises under examination conditions, students occasionally fail to make the totals of the Balance Sheet agree, but the adoption of methods similar to those outlined above will enable the examinee, working systematically and carefully, to discover and adjust the error.

Questions in examinations frequently include a list of ledger balances, without indicating whether any particular item is a debit or a credit balance, from which the final accounts and Balance Sheet are to be prepared. In such a case it is advisable to ascertain that the figures do, in fact, balance before proceeding to prepare the Trading and Profit and Loss Accounts and Balance Sheet. Where the question does not call for the preparation of a Trial Balance, the list of balances may be quickly proved by "bracketing" the credits (these are almost invariably fewer in number than the debits) and adding them up, and then adding up the entire list of balances and dividing by 2; the result obtained should, if the books balance, equal the total of the credit balances. Where, however, the balances are not listed in columnar form, it will be necessary to jot them down on a sheet of paper and the debits and credits will be set out in separate columns in the process.

It will occasionally be found that the Trial Balance totals disagree by a very large sum—e.g., £25,000. If the debit total is greater than the credit, the difference is probably due to the omission of the Capital Account. Where the credit total is greater than the debit the difference may represent the amount of the goodwill, particularly if the accounts are those of a newly-acquired business.

The examinee is warned, however, against blindly making additions to the Trial Balance; only after the most careful investigation has failed to disclose any error should an account be inserted in this manner, and in all cases an explanation of what has been done, and the reasons therefor, should be given in a footnote.

A modern method of compiling a Trial Balance is that by which four columns are utilised, revenue items being inserted in the first pair of columns and Balance Sheet items included in the second pair. The balance of the first pair of columns should equal the contra balance shown on the second pair of columns, thereby proving the accuracy of the total balance. It will be found that this method will facilitate the preparation of the final accounts.

THE FUNCTION OF THE TRADING ACCOUNT

The main function of the Trading Account is the ascertainment of the gross profit for the period, but, as will be explained

later, subsidiary functions are the affording of an approximate check on the gross profit, and opportunities for a comparison with the results attained in previous periods. Obviously, where the component items vary in successive accounts, it is impossible to make even an approximate comparison, and therefore, this account should be standardised, i.e., the same items should appear in similar form in the successive final accounts so that an effective comparison may be made of one trading period with another. The actual items in the trading accounts of different classes of undertaking will necessarily vary according to the nature of the nominal accounts in the respective businesses ; for example, Customs Duty, Licences, and Freight and Insurance on inward shipments of raw materials will be essential items of the trading account of a cigarette manufacturer, but these particular items would not appear in the trading account of a colliery.

The following is the usual method of preparing the Trading Account. On the debit side are placed :—

1. Stock at commencement of period.
2. Purchases during period (less returns outwards).
3. All *purchasing* and *manufacturing* expenses, such as productive wages, carriage *inwards*, and other items which vary directly with the turnover.

The account is credited with—

1. Sales during the period (less returns inwards).
2. Stock at end of period.

The balance then remaining on the account will be the gross profit or loss as the case may be, which will be carried to the Profit and Loss Account.

THE FUNCTION OF THE PROFIT AND LOSS ACCOUNT

The main function of the Profit and Loss Account is to ascertain the net profit resulting from the trading operations of the period, and, with a partnership firm, to show the distribution of that profit among the partners in accordance with the terms of the partnership agreement.

This account is debited with the gross loss (if any) from the Trading Account, and with the selling, establishment, and distribution expenses for the period, and is credited with the gross profit (if any) from the Trading Account and with any miscellaneous gains made, such as interest and discounts received.

Examination questions sometimes require the preparation of Profit and Loss Account and Balance Sheet only, the Trial Balance having been prepared, in such cases, *after* the Trading Account has been completed. It will then be found that the gross profit

or loss appears as one of the balances and is entered to the credit or the debit of the Profit and Loss Account, as the case may be. The stock which appears in the Trial Balance in such cases is the *closing* stock, which, being a ledger account balance and not an adjustment, requires entering once only in the final accounts, *viz.*, in the Balance Sheet. The *opening* stock no longer appears, having already been debited to Trading Account prior to the extraction of the Trial Balance.

It is of the utmost importance to know the amount of expenditure on each of the various services required to earn the gross profit, what proportions they bear to each other and to the gross profit, and how they compare with similar items of previous periods. In this connection, the Profit and Loss Account cannot be standardised to the same extent as the Trading Account, owing to the fact that more variations occur, but much useful information can nevertheless be obtained.

Where the nominal accounts are suitably subdivided, their relative importance can be adequately realised, and excessive expenditure in any direction can be localised, enabling the trader to take steps to remedy it in future years.

With partnership firms, the distribution of the net profits among the partners is best shown in a continuation of the Profit and Loss Account—the Profit and Loss Appropriation Account—as indicated in the example on page 244.

THE FUNCTION OF THE BALANCE SHEET

The main function of the Balance Sheet is the presentation of a concise summary of the liabilities and assets in a well-arranged intelligible form, so that the financial position of the trader, firm, or company on the date of the statement may be clearly ascertained.

It was suggested in Chapter IV that the assets are best arranged in order of their permanence, and for this purpose they may conveniently be classified into four groups, viz. :—

1. Fixed Assets, such as Land and Buildings, Plant and Machinery, etc. Those fixed assets which, by their nature, are consumed in the service of the business by effluxion of time (e.g., leases), or by wear and tear (e.g., machinery), or by consumption (e.g., mines), are known as *Wasting Assets*.
2. Floating Assets, such as Stock-in-trade, Book Debts, etc.
3. Liquid Assets (a sub-division of (2)), such as Investments and Cash, which are readily realisable and available.

4. FICTITIOUS ASSETS, e.g., a debit balance on Profit and Loss Account, Preliminary Expenses, and any other debit items that do not possess any realisable value.

The best method of arranging the liabilities in the case of a sole trader or of a partnership is the order in which they rank for payment, as indicated below; the usual grouping in the case of a limited company will be dealt with in a later chapter.

1. Trade Creditors.
2. Creditors for Expenses.
3. Loans (if any).
4. Partners' Current Accounts.
5. Partners' Capital Accounts.

In the event of any debit balances accruing on either the partners' current or capital accounts, they will be separately shown as the last items on the assets side of the Balance Sheet.

The correct grouping of the assets and liabilities is most effective in that it shows the relative importance of the several items, and indicates—

(*a*) whether too much capital is locked up in the fixed assets; and

(*b*) whether the floating and liquid assets are sufficient to meet the current liabilities, and whether they exist in properly balanced proportions to facilitate future trading.

Contingent Liabilities are transactions, the result of which is not yet known, and which may or may not involve the payment of money at some future date; as, for example, in the case of bills receivable discounted, some of these may not have been met at the date of a Balance Sheet. If the acceptor of one of these bills fails to meet it at the due date, the holder will have a right of recourse against the drawer or any prior indorser, and there is, therefore, a contingent liability on the drawer or any indorser for the amount of the bill.

A note of this liability should therefore be made on the Balance Sheet of the drawer or indorser as follows:—

> "There is a contingent liability in respect of Bills Receivable under discount amounting to £—."

Additional examples are law costs and possible damages in a pending action; also, where shares are issued and only a part of the nominal amount thereof is called up, there is a contingent liability on the shareholder to pay the uncalled amount if and when called upon to do so. Where partly paid shares are held as investments, therefore, they should be stated in the holder's balance sheet to be only partly paid up in such a way that the

amount unpaid is apparent, e.g., "200 shares of £1 each in Blank Co., Ltd., 10s. paid up." From this it is clear that there is a contingent liability to the extent of 10s. on each share.

Percentage Trading and Profit and Loss Accounts.

The use of percentages in the final accounts affords great advantages to a trader inasmuch as the true relative value and importance of each item can be readily seen and appreciated. There are several methods of using percentages for this purpose, the principal being :—

1. The percentage which each item of expense, etc., bears to the turnover.
2. The percentage which each item bears to the cost price.
3. The percentage which each item bears to the gross profit.

The first method, which takes the total net sales as the basis for the calculations, is usually the most convenient and useful system, and will be found to be the one most commonly adopted in practice. The percentage is obtained by multiplying each item by 100 and dividing the resulting figure by the total net sales.

EXAMPLE.

From the following information prepare a Trading Account showing the percentage which each item of expense bears to the turnover :—

	£
Stock at beginning of year	10,000
Purchases	45,200
Purchases Returns	200
Wages	6,000
Sales	66,000
Sales Returns	1,000
Stock at end of year	12,000

TRADING ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	%	£		%	£
To Commencing Stock		10,000	By Sales, *less* Returns	100·00	65,000
Add Net Purchases		45,000			
		55,000			
Deduct Closing Stock		12,000			
„ Materials used	66·15	43,000			
„ Wages	9·23	6,000			
„ Balance, being Gross Profit	24·62	16,000			
	100·00	£65,000		100·00	£65,000

It will be observed that the percentage for materials is based on the cost of the goods *used*, this being of greater significance than the percentages to sales of the net purchases and the opening and closing stocks.

The following is a complete example of "Percentage" Trading and Profit and Loss Accounts, compiled from particulars given in a Trial Balance.

EXAMPLE.

The Trial Balance as set out below is extracted from the books of a firm *A* and *B* selling manufactured goods. You are required to draft from it a Balance Sheet and Trading and Profit and Loss Accounts, showing the percentage of each revenue item to the turnover. The period covered by the transactions is for the twelve months ended 30th June, 19..

	Dr.	*Cr.*
	£	£
Capital Account *A*		3,500
Capital Account *B*		3,500
Drawing Account *A*	1,800	
Drawing Account *B*	1,800	
Purchases	47,000	
Sales		58,000
Discounts	1,198	1,599
Investments in Shares	3,198	
Salaries	766	
Rent—Office	250	
Rent—Warehouse	180	
Insurances, Fire, etc.	106	
Insurances on Purchases	753	
General Expenses	326	
Travelling Expenses	1,664	
Stock at commencement of period	4,730	
Freight	295	
Cash at Bank	533	
Cash in hand	8	
Furniture and Fixtures	315	
Sundry Debtors	4,700	
Sundry Creditors		4,962
Lighting	21	
Rates, etc.	109	
Bank Charges	7	
Boxes and Packing Materials	269	
Wages	1,533	
	£71,561	£71,561

The Stock at end of the period was £3,020.

TRADING AND PROFIT AND LOSS ACCOUNTS.

Dr. FOR THE YEAR ENDED 30TH JUNE, 19... *Cr.*

	%	£		%	£
To Commencing Stock		4,730	By Sales	100	58,000
Add Purchases		47,000			
		51,730			
Less Closing Stock		3,020			
,, Materials used	83·98	48,710			
,, Wages	2·64	1,533			
,, Freight*	·51	295			
,, Insurance on Purchases	1·30	753			
,, Gross Profit *c/d.*	11·57	6,709			
	100·00	£58,000		100	£58,000
To Salaries	1·32	766	By Gross Profit *b/d.*	11·57	6,709
,, Rent	·74	430	,, Discounts Received	2·75	1,599
,, Rates, etc.	·19	109			
,, Fire Insurance, etc.	·18	106			
,, General Expenses	·56	326			
,, Discounts Allowed	2·07	1,198			
,, Travelling Expenses	2·87	1,664			
,, Boxes, etc.	·46	269			
,, Lighting	·04	21			
,, Bank Charges	·01	7			
,, Net Profit *c/d.*	5·88	3,412			
	14·32	£8,308		14·32	£8,308
To Division of Profits †—			By Net Profit *b/d.*		3,412
A . . . £1,706					
B . . . 1,706					
		3,412			
		£3,412			£3,412

* Freight is assumed to represent carriage inwards. If the freight is upon goods sold, the item should be included in the Profit and Loss Account.

† As the proportion in which profits are shared is not stated, it is assumed that they are divided equally between the partners, in accordance with Section 24, Partnership Act, 1890 (see page 168).

BALANCE SHEET.

AS AT 30TH JUNE, 19...

Liabilities.	£	£	*Assets.*	£	£
Sundry Creditors		4,962	Furniture and Fittings		315
Capital Accounts—			Investments		3,198
A	3,500		Stock		3,020
B	3,500	7,000	Sundry Debtors		4,700
			Cash at Bank	533	
			Cash in hand	8	541
			Current Accounts—		
			A—Drawings	1,800	
			Less Share of Profits	1,706	94
			B—Drawings	1,800	
			Less Share of Profits	1,706	94
		£11,962			£11,962

NOTE.—It will be observed that, in this example, the partners' drawings are greater than the profits realised. Where the partners' capitals are "fixed," the amounts to the debit of their current accounts should preferably be refunded to the firm, although other arrangements may, of course, be made, by agreement between the partners.

Comparative Trading and Profit and Loss Accounts.

One of the greatest advantages to be derived from the keeping of proper accounts is the comparison that can be made between the figures relating to successive trading periods. This is best accomplished by setting out the accounts in columnar form showing the figures and percentages for two or more periods side by side. While " percentage " accounts for a single year yield useful information, the accounts of two or more periods arranged comparatively in columnar form intensify this utility, and the relative importance of each item is apparent at a glance. In order that the percentage comparisons may prove of real value the accounts *must* be prepared on a uniform basis.

An example, showing the figures for two years for the Balance Sheet and Trading and Profit and Loss Accounts is given on page 246. From an examination of the figures shown in the Trading Account it is seen that there has been an increase in the turnover, but the percentages indicate that the cost price of the materials has fluctuated only slightly ; the standard rate of gross profit has not only been maintained but has increased.

In the Profit and Loss Account, the fixed charges for Rent, etc., and Insurance show a decrease in the percentage rate owing to the amounts being distributed over a larger turnover. The depreciation charge also shows a lower percentage, both because of the increased turnover and by reason of the fact that the reducing instalment system of writing off depreciation has been adopted. Advertising shows an increase both in amount and percentage rate, but it sometimes occurs that the full benefit of advertising expenditure is not realised until later years.

Travelling Expenses show an increase in amount but a decrease in percentage, while Sundry Expenses and Discounts have increased both in amount and in percentage. Variations of this nature indicate the desirability of investigation in respect of both the correctness of the amounts charged and the cause of the variations. The remaining items call for little or no comment, but a careful study of this example will demonstrate the utility of accounts prepared in such a manner.

In general, however, percentages in the Profit and Loss Account are not of as great importance as percentages in the Trading Account, since many Profit and Loss Account items, such as rent, are " fixed " (i.e., they do not move in accordance with turnover), and a change in their percentage as between one year and the next may simply be a reflection of a change in the turnover upon which the percentage is based.

Another form of comparative final accounts is used when different persons are interested in the accounts for portions of the trading period. In such cases the columnar form may again be used advantageously. An example of this type of comparative columnar account is given on page 248, the apportionment being necessary as a result of the admission of a new partner.

Dr. COMPARATIVE TRADING AND PROFIT AND LOSS ACCOUNTS. *Cr.*

	Year ended.. (*Previous year.*)		Year ended 31st Dec. 19...			Year ended.. (*Previous year.*)		Year ended 31st Dec. 19...	
	%	£	%	£		%	£	%	£
To Materials used	48·68	18,500	48·89	22,000	By Sales	100·00	38,000	100·00	45,000
„ Wages	32·90	12,500	33·44	14,600					
„ Coal and Coke	1·32	500	1·38	620					
„ Gross Profit *c/d.*	17·10	6,500	17·29	7,780					
	100·00	£38,000	100·00	£45,000		100·00	£38,000	100·00	£45,000
To Rent, Rates, and Taxes	·92	350	·78	350	By Gross Profit *b/d.*	17·10	6,500	17·29	7,780
„ Insurance	·24	90	·20	90	„ Discounts Received	1·25	475	1·29	580
„ Salaries	2·89	1,100	2·89	1,300					
„ Advertising, etc.	·68	260	·80	360					
„ Stationery	·32	120	·31	140					
„ Travelling Expenses and Commission	1·91	725	1·88	845					
„ Sundry Expenses	·59	225	·62	280					
„ Bad Debts	·79	300	·72	325					
„ Discounts Allowed	2·58	980	2·71	1,220					
„ Interest on Capital	2·63	1,000	2·22	1,000					
„ Depreciation	4·13	1,570	3·18	1,429					
„ Net Profit *c/d.*	·67	255	2·27	1,021					
	18·35	£6,975	18·58	£8,360		18·35	£6,975	18·58	£8,360
To Partners' Current Accounts—					By Net Profit *b/d.*		255		1,021
A		128		510					
B		127		511					
		£255		£1,021			£255		£1,021

COMPARATIVE BALANCE SHEET OF *A* AND *B*.

Liabilities.	31st Dec. 19...*	31st Dec. 19...	
	£	£	£
Sundry Creditors	*18,900*		21,600
Capital Accounts—			
A	*8,000*	8,000	
B	*12,000*	12,000	
			20,000
Current Accounts—			
A—Balance		1,100	
Interest on Capital		400	
Share of Profits for Year		510	
		2,010	
Less Drawings		850	
	1,100		1,160
B—Balance		1,080	
Interest on Capital		600	
Share of Profits		511	
		2,191	
Less Drawings		850	
	1,080		1,341
	£41,080		£44,101

Assets.	31st Dec. 19..*	31st Dec. 19...	
	£	£	£
Land and Buildings		5,700	
Less Depreciation @ 5% p.a.		285	
	5,700		5,415
Plant and Machinery		6,750	
Less Depreciation @ 10% p.a.		675	
	6,750		6,075
Patents		4,500	
Less Depreciation @ 10% p.a.		450	
	4,500		4,050
Fittings and Fixtures		380	
Less Depreciation @ 5% p.a.		19	
	380		361
Stock-in-trade	*9,000*		9,500
Sundry Debtors	*11,200*		14,625
Cash at Bank and in hand	*3,550*		4,075
	£41,080		£44,101

* Previous year.

EXAMPLE.

A and *B* are partners in a retail business, sharing profits equally. On 1st September 19.. they take *C* into partnership on the terms that he is to receive one-fifth of the profit and a salary of £150 per annum. Interest on the partners' Capital Accounts is to be allowed at 5% per annum. Stock was not taken at the date of *C's* entry into the firm, but it was agreed that, for the purpose of ascertaining *C's* share, gross profits should be apportioned on the basis of net sales. The following are the Trial Balances extracted from the books of the firm at 31st August 19.. and 31st December 19.. respectively.

	31st August 19..						31st December 19..					
	Dr.			Cr.			Dr.			Cr.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
Capital Accounts—												
A				3,000	0	0				4,000	0	0
B				2,000	0	0				3,000	0	0
C										750	0	0
Drawing Accounts—												
A				50	0	0	125	0	0			
B	75	0	0				150	0	0			
C							75	0	0			
Goodwill . . .							2,000	0	0			
Stock, 1st January .	6,078	10	4				6,078	10	4			
Purchases . . .	6,596	2	9				10,673	0	9			
„ Returns .				49	5	9				62	12	6
Sales				8,179	17	1				13,122	9	7
„ Returns . .	43	1	3				123	9	2			
Salaries . . .	435	0	0				620	0	0			
Rent and Rates . .	450	11	0				757	9	9			
Office Expenses . .	47	15	9				78	1	4			
Sundry Debtors . .	491	11	1				516	2	1			
„ Creditors .				1,151	2	2				742	8	7
Cash at Bank . .	207	8	3				468	14	2			
Cash in hand . .	5	4	7				12	3	1			
	£14,430	5	0	£14,430	5	0	£21,677	10	8	£21,677	10	8

You are required to prepare separate Profit and Loss Accounts for the eight months ended 31st August, and for the four months ended 31st December, and a Balance Sheet as on the latter date.

The Stock on 31st December was £6,461 2s. 1d. No entries had been put through the books in connection with *C's* salary.

All apportionments necessary are to be made in months.

COMPARATIVE FINAL ACCOUNTS (used on Admission of Partner).

TRADING AND PROFIT AND LOSS ACCOUNTS.

FOR THE YEAR ENDED 31ST DECEMBER, 19. .

Dr. | *Cr.*

	8 Months ended 31st Aug.	4 Months ended 31st Dec.	Total for Year.		8 Months ended 31st Aug.	4 Months ended 31st Dec.	Total for Year.
	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.	£ s. d.
To Stock at 1st Jan.			6,078 10 4	By Sales (*less* Returns)	8,136 15 10	4,862 4 7	12,999 0 5
,, Purchases (*less* Returns)	6,546 17 0	4,063 11 3	10,610 8 3	,, Stock @ 31st Dec.			6,461 2 1
,, Gross Profit *c/d.*			2,771 3 11				
			£19,460 2 6				£19,460 2 6
To Rent and Rates	450 11 0	306 18 9	757 9 9	By Gross Profit *b/d.*	1,734 12 10	1,036 11 1	2,771 3 11
,, Salaries	435 0 0	185 0 0	620 0 0				
,, Office Expenses	47 15 9	30 5 7	78 1 4				
,, *C's* Salary		50 0 0	50 0 0				
,, Net Profit *c/d.*	801 6 1	464 6 9	1,265 12 10				
	£1,734 12 10	£1,036 11 1	£2,771 3 11		£1,734 12 10	£1,036 11 1	£2,771 3 11
To Interest on Capital—							
A	100 0 0	66 13 4	166 13 4	By Net Profit *b/d.*	801 6 1	464 6 9	1,265 12 10
B	66 13 4	50 0 0	116 13 4				
C		12 10 0	12 10 0				
,, Partners' Current Accounts—							
A	317 6 5	134 1 4	451 7 9				
B	317 6 4	134 1 5	451 7 9				
C		67 0 8	67 0 8				
	£801 6 1	£464 6 9	£1,265 12 10		£801 6 1	£464 6 9	£1,265 12 10

A, B AND C.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£ s. d.	£ s. d.	*Assets.*	£ s. d.	£ s. d.
Sundry Creditors .		742 8 7	Goodwill . .		2,000 0 0
Current Accounts—			Stock on hand .		6,461 2 1
A	493 1 1		Sundry Debtors .		516 2 1
B	418 1 1		Cash at Bank .	468 14 2	
C	54 10 8		Cash in hand .	12 3 1	
		965 12 10			480 17 3
Capital Accounts—					
A	4,000 0 0				
B	3,000 0 0				
C	750 0 0				
		7,750 0 0			
		£9,458 1 5			£9,458 1 5

Great care needs to be exercised in the use of comparative accounts, for it is easy to come to wrong conclusions. In particular, note *the importance of selecting the right items for comparison.* Thus, the percentages which purchases and opening and closing stocks bear to sales are meaningless, if not dangerously misleading; on the other hand, the percentage which *materials consumed* (i.e., the net figure of purchases, as adjusted in respect of stocks) bears to sales is of vital importance.

An increase in the financial figure for sales does not necessarily imply an increase in the *volume* of sales, for selling prices may have risen. Conversely, a decrease in the sterling figure for sales does not necessarily imply a decrease in the volume of sales, for selling prices may have fallen.

Some percentages may move directly, and others inversely as a result of changing conditions of production, or different business policies (e.g., a change from hand to machine manufacture of certain goods would result in an increase in the percentage of Power and of Depreciation of Machinery and a reduction in the percentage of Wages).

An indication of the causes which might lead to a fluctuation in percentages may be obtained from a study of the following which, although by no means exhaustive, represents a fair selection of the probable causes of an *increase* in the percentage of gross profit. It should also be mentioned that these causes are not mutually exclusive but may quite well operate together.

(1) Understatement in value and/or quantity of the opening stock, or, conversely, overstatement of the closing stock.

(2) Suppression of purchase invoices or lower buying prices.

(3) Purchase of factory premises and elimination of charge for rent.
(4) Reduction in wages or better work.
(5) Inflation by inclusion of fictitious sales.

Manufacturing Accounts.

The term "Manufacturing Account" is sometimes used as being synonymous with a Trading Account, and a manufacturer's Trading Account is often thus described. This usage of the term, however, is not strictly correct. A manufacturing account proper, which may also be described as a "Production Account," should show the cost of producing the goods dealt in by the manufacturer. The Trading Account will then deal solely with the sale of goods, and will be debited with the "cost of production" of the goods instead of with the total purchases for the period, as is usual in traders' accounts.

Manufacturing Accounts are generally used by large manufacturing concerns, and in such cases it is a common practice to charge factory rent, depreciation and repairs of plant, etc., to such accounts, while warehouse rent and warehouse wages are charged in the Trading Account, as shown in the following example.

Dr. MANUFACTURING ACCOUNT. *Cr.*

FOR THE YEAR ENDED 31ST DECEMBER, 19..

	£	£		£
To Materials consumed:—			By Balance, being Cost of Production transferred to Trading Account . .	16,570
Stock 1st Jan.	2,460			
Purchases .	9,500			
	11,960			
Less Stock, 31st Dec.	2,600			
		9,360		
,, Carriage Inwards . .		350		
,, Factory Rent . . .		200		
,, Factory Wages . .		6,400		
,, Fuel, Electric Light, and Power		260		
		£16,570		£16,570

TRADING ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	£		£
To Stock of Manufactured Goods on 1st January .	5,600	By Sales	22,500
,, Cost of Goods made during year	16,570	,, Stock of Manufactured Goods on 31st December	5,100
,, Warehouse Rent . .	400		
,, Warehouse Wages . .	1,800		
,, Balance, being Gross Profit	3,230		
	£27,600		£27,600

Some concerns use a Manufacturing Account to ascertain the Gross Profit on *Manufacture*, the Trading Account disclosing the Gross Profit on *Trading*. The market price of the manufactured goods is credited to Manufacturing Account and debited to Trading Account; the credit balance on Manufacturing Account then represents the Gross Profit earned in manufacturing the goods. (Conversely, a debit balance on Manufacturing Account will indicate a loss on manufacturing the goods.) This profit should be added to, (or if a loss, deducted from), the Gross Profit on trading, in the *Profit and Loss Account*. An example is given on page 252.

Considerable variations occur in the requirements of examination questions with regard to the preparation of Manufacturing, Trading and Profit and Loss Accounts. The nature of the business carried on may provide a clue to the method of setting out the final accounts, and any information given in the question should be read carefully in conjunction with the wording of the examiner's requirements. Thus, although a question may call for the preparation of Manufacturing Account and Profit and Loss Account, sufficient information may be given to enable a Trading Account to be prepared in addition (e.g., separate figures may be supplied for Stocks of Raw Materials, Work-in-Progress, and Stocks of Finished Goods); if so, such an account should be submitted. Again, a Manufacturing Account may be called for in circumstances in which, owing to the limited amount of information given in the question, only a combined Manufacturing and Trading Account can be prepared, and sub-division between the two accounts may therefore be impossible.

The nature of the business should also be borne in mind in considering where to charge certain items. Thus, in the case of a manufacturing concern most authorities are in agreement that depreciation of plant and machinery should be debited to Manufacturing Account as part of the cost of production; but where only Trading Account and Profit and Loss Account are to be prepared, depreciation is often charged to Profit and Loss Account, although many authorities prefer to charge it to Trading Account. Where alternative treatments exist it is usually advisable to add a footnote to the answer to an examination question, pointing out the alternative treatment to that which has been followed.

EXAMPLE.

MANUFACTURING, TRADING AND PROFIT AND LOSS ACCOUNTS.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

		£		£
To Stock of Raw Materials, 1st Jan. 19..		3,000	By Cost of Goods Manufactured *c/d.*	55,000
,, Purchases		23,000		
		26,000		
Less Stock of Raw Materials, 31st Dec. 19..		1,000		
		25,000		
,, Wages		15,000		
,, Factory Expenses		10,000		
,, Work in Progress—1st Jan. 19..	£7,000			
Less Work in Progress—31st Dec. 19..	2,000			
		5,000		
		£55,000		£55,000
To Cost of Goods Manufactured *b/d.*		55,000	By Market Value of Goods Manufactured *c/d.*	65,000
,, Gross Profit on Manufacture transferred to Profit and and Loss Account		10,000		
		£65,000		£65,000
To Stock of Finished Goods, 1st Jan. 19..		12,000	By Sales	75,000
,, Market Value of Goods Manufactured *b/d.*		65,000		
		77,000		
Less Stock of Finished Goods, 31st Dec. 19..		17,000		
		60,000		
,, Gross Profit on Trading *c/d.*		15,000		
		£75,000		£75,000
To Salaries		2,000	By Gross Profit on Trading *b/d.*	15,000
,, Rent and Rates		1,300	,, Gross Profit on Manufacture *b/d.*	10,000
,, General Expenses		10,000	,, Discounts	700
,, Carriage Outwards		400		
,, Travellers' Commissions		3,000		
		16,700		
,, Net Profit		9,000		
		£25,700		£25,700

Charges in Lieu of Rent.

Where a business concern is the owner-occupier of its premises and consequently does not pay any rent, it is frequently found that

in order to show the correct cost of manufacture, gross profit or loss, and net profit or loss, a debit entry in lieu of rent is shown in the financial accounts of the business. Usually the debit entry is equivalent to the amount of the assessment on the premises for taxation or rating purposes.

The debit entry is normally shown either in the Manufacturing or Trading Account and is offset by a corresponding credit, shown separately, either in—

(i) the Profit and Loss Account ; or
(ii) the Profit and Loss Appropriation Account ; or
(iii) (in the case of a sole trader) the Capital Account.

The main object of these entries is to enable more accurate percentage calculations to be made in order to guide the owners of the business in determining the separate results of manufacture or trading, as distinct from the combined results of their trading and general financial policy (e.g., the benefits resulting from the purchase of their own premises).

Subsidiary Trading or Working Accounts.

In addition to the trading accounts compiled to ascertain the gross profit on goods sold, subsidiary trading accounts are sometimes raised for "side lines" to ascertain the profit realised (or loss sustained) on these extraneous ventures. The balance of each of these subsidiary accounts is debited or credited, as the case may be, to the Profit and Loss Account. An example of this class of account is the "Directors' Fees" Account of a firm of accountants shown on page 185.

In a similar manner, a "Working Account" is occasionally constructed to show the cost of working some particular department of the business. The relative expenses incurred are debited to the Working Account, which is credited (on an agreed basis) with the estimated value of the work performed.

EXAMPLE.

A firm of merchants incurs heavy charges for cold storage on imported goods, such charges being debited to Cold Storage Charges Account. They convert a portion of their own premises into a cold store. A record is kept of goods stored and of the period of storage, and rentals "earned" (calculated on the basis of charges by independent cold stores) are ascertained therefrom to amount to £3,300 for the year 19..

Expenses in connection with the cold storage for the year are :—

	£
Wages	650
Power	870
Repairs	126
General Expenses	146

Depreciation: Gas Engine, etc., 10% on cost, £1,780; other capital expenditure, 20% on cost, £2,400.

Show the Cold Store Working Account for the year ended 31st December, together with the relative journal entries.

JOURNAL.

			Dr.	Cr.
19..			£	£
Dec. 31	Cold Store Working Account . . *Dr.*		2,450	
	To Sundries, viz.:—			
	Wages			650
	Power			870
	Repairs			126
	Depreciation of Gas Engine . .			178
	" other Capital Expenditure			480
	General Expenses			146
	Being transfer of cold storage expenses during year 19..			
" "	Cold Store Charges Account . . *Dr.*		3,300	
	To Cold Store Working Account . .			3,300
	Being value of rentals "earned."			
" "	Cold Store Working Account . . *Dr.*		850	
	To Profit and Loss Account . . .			850
	Being net "earnings" of Cold Store for the year.			
" "	Profit and Loss Account . . . *Dr.*		3,300	
	To Cold Store Charges Account . .			3,300
	Being rental charge for cold storage during year.			

COLD STORE WORKING ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DECEMBER 19.. *Cr.*

		£			£
To Wages		650	By Cold Store Charges Account . . .		3,300
" Power		870			
" Repairs		126			
" Depreciation—					
Gas Engine . .		178			
Other Capital Expenditure . .		480			
" General Expenses .		146			
" Balance, being Net Earnings transferred to Profit and Loss Account . . .		850			
		£3,300			£3,300

The Significance of Gross Profit.

One of the chief reasons for the sub-division between Trading Account and Profit and Loss Account is the necessity for ascertaining the gross profit on trading.

The gross profit of a merchant is the difference between the price at which he buys goods and that at which he sells them. Certain expenses such as carriage inwards and warehousing charges are directly attributable to specific items of merchandise and are incurred only if goods are purchased. Such expenses are charged in the Trading Account, before the balance, representing gross profit, is struck. Other expenses such as rent, rates, salaries, selling and distributive expenses are not directly attributable to specific purchases of goods and are charged in the Profit and Loss Account after the gross profit has been ascertained. These "overhead charges," within certain limits, may well be reasonably constant. While business is being carried on at all, it will not be possible to reduce them below a certain minimum. This minimum expenditure, however, would probably be sufficient for a fairly considerable volume of business and within certain limits it may be said that :—

(*a*) a certain amount of gross profit is necessary to cover the fixed overhead charges, and

(*b*) any increase in the gross profit is reflected in an almost corresponding increase in the net profit.

But this statement is only true within certain limits; obviously a business cannot be expanded indefinitely without some increase in overhead charges. Furthermore, some overhead charges are matters of policy and may actually be increased in times of poor trade ; this is particularly true of advertising.

Observe that in times of bad trade, it may be advisable for goods to be sold at any price that will reveal a rate of gross profit, however small, for in this way a proportion of the fixed overhead charges, which would otherwise be a dead loss to the business, will be recovered.

It must be remembered that the gross profit shown by the Trading Account is a *total* result and, as such, may be said to represent the gross profit on all the profitable lines *less* the gross loss on all the unprofitable lines which show different degrees of profit, thus—

ARTICLES.

	A.	*B.*	*C.*	Total.
	£	£	£	£
Sales	10,000	12,000	15,000	37,000
Gross Profit	2,000	2,000	5,000	9,000
%	20	16.6	33.3	24.3

NOTE.—The nature of the total percentage should not be misunderstood. It represents the percentage of the *average gross profit* and not the average of the percentages, which will be seen to be 23.3%.

The importance of analysis is clearly demonstrated in this case, for if the business could concentrate entirely on Article *C* and produce and sell £27,000 worth, the same gross profit would be realised and probably with less effort. It would in such circumstances, pay to discard lines *A* and *B* (unless, of course, the sales of *A* and *B* encouraged the sales of *C*, when, as a matter of policy, it might be advisable to continue the first two lines). Since the total sales as above are £37,000, it should not be difficult to institute a new sales level of £27,000 in article *C* only, which would produce £9,000 gross profit. Thus, an important step in business policy may be taken directly as a result of an analysis of figures.

Rate of Turnover of Stock.

The rate of turnover of stock is computed by dividing the cost of goods sold (i.e., purchases as adjusted in respect of stocks) by the average stock held during the period (i.e., the average of the opening and closing stocks).

Consider the figures in the following Trading Account:—

	£		£
To Stock, 1st January ..	8,000	By Sales	60,000
,, Purchases	44,000	,, Stock, 31st December	12,000
,, Gross Profit	20,000		
	£72,000		£72,000

The *cost of goods sold* is £44,000 + £8,000 − £12,000 = £40,000.

The *average stock* is $\frac{£8,000 + £12,000}{2} = £10,000$.

The *rate of turnover of stock* is $\frac{40,000}{10,000} = 4$ times per annum.

If the rate of turnover (alternatively termed the " velocity of turnover ") is divided into twelve, the result shows the average time in months for which an item remains in stock before it is sold (e.g., 3 months, in the above example). But do not forget that this is an average rate and that the sale of certain popular and " quickly moving " lines may cloak the presence of old stock which can only be sold with the greatest of difficulty.

Generally speaking, a trader who has accumulated quantities of old stock is left with two alternatives—he may lower the prices in the hope of early realisation *or* he may retain the normal prices in the hope that sales will eventually materialise. The first course of action will be reflected by a fall in the rate of gross profit ; the second, while the unsold stock is still valued at cost, will not cause the rate of gross profit to fall but it will be reflected by a drop in the rate of turnover.

A low rate of turnover has many disadvantages. Clearly it

involves the carrying of a larger stock to maintain a given volume of sales than would be necessary with more quickly moving goods. The larger stock requires additional capital or will involve loan or bank interest or loss of discount for prompt payment of creditors' accounts. It will also attract storage charges or require additional space in the merchant's warehouse, with attendant overhead charges. Finally, in any trade that is subject to the whims and caprices of fashion, the retention of stock for longer than is really necessary adds considerably to the risk of its becoming unmarketable.

The necessity for "departmentalising" the accounts when there are different lines of goods must not be overlooked. Rates of turnover and of gross profit become meaningless when they consist of heterogeneous mixtures of different rates and it is impossible to tell whether fluctuations from one year to another are due to mere changes in the proportions of goods sold or to more serious factors. Departmentalisation does not necessarily involve the splitting up of the business premises into different departments, although this will be done in some cases. It can be secured by analysing the Purchases Day Book, Sales Day Book, Returns Outwards Book, Returns Inwards Book, and by evaluating the opening and closing stocks separately. The process of departmentalisation is not, as a rule, extended to the personal accounts of the firm's debtors and creditors, each of whom usually has a single personal account, irrespective of the classes of goods sold to or bought from him.

EXERCISE 7.

A. State shortly how capital expenditure can be distinguished from revenue expenditure.

B. Explain the terms "fixed" and "floating" assets; give three examples of assets which may be fixed as regards one business and floating as regards another; and describe the difference, if any, in the obligation to provide for depreciation in connection with them.

C. State how you would satisfy yourself as to the correctness of the values placed on the following assets appearing in a Balance Sheet: (*a*) Fixed Plant and Machinery; (*b*) Loose Plant and Tools; (*c*) Furniture; (*d*) Horses; (*e*) Motor Vans.

D. Give the forms of entry originating the undermentioned accounts in the books:—

(*a*) Suspense.
(*b*) Payments in advance.
(*c*) Contingent liability.
(*d*) Created goodwill.

Define in each case the purpose for which the account is opened.

E. Give a short description of each of the following methods of providing for depreciation: (*a*) Fixed Instalment System; (*b*) Reducing Instalment System; (*c*) Depreciation Fund System; (*d*) Insurance Policy System; (*e*) Annuity System; (*f*) Revaluation System.

F. What is the difference between depreciation and fluctuation in value of plant and machinery? How would depreciation and fluctuation respectively, as regards plant and machinery, affect the accounts of a trading concern?

G. V. Crosswell purchased a printing machine for £1,000. The useful life of the machine was estimated at 10 years. Upon purchasing the machine, Crosswell took out a "Pure Endowment Policy" with the Premier Assurance Company for £1,000, payable in 10 years. How would you treat the annual premiums payable under this policy, and how would the question of depreciation be affected?

H. A trading company having purchased the lease of its business premises, takes out a policy for its redemption. To what account should the yearly premium be charged? Show the position of that account, and of the redemption account when the policy matures, and set out the necessary journal entries arising in connection therewith.

I. Give four examples of errors which may exist in a set of books notwithstanding that the Trial Balance agrees.

J. State in detail what steps you would take to locate an error in a Trial Balance.

K. Having checked all postings and balances you find the Trial Balance does not agree. What would you suggest in order to localise the error?

L. The following errors have been made in the books of a company. What entries will be necessary to correct them?—

B has been debited with goods £40 when he should have been credited.

Goods for £80 received from *X* have been credited both to *X* and *Y*.

M. Messrs *A* and *B's* chief clerk presents you with a Trial Balance which disagrees. Upon examination you find the following errors, which, upon being rectified, bring the Trial Balance to an agreement.

Will the profit be affected by your corrections, and what was the original difference in the Trial Balance?

	£
Purchases addition too much by	50
Electro Catalogues not inserted in Trial Balance	30
Sale of old plant not credited to the Asset Account	60
Sale to a customer—in Ledger Account, but not passed through Sales Day Book	15
Goods purchased entered in Bought Day Book, but not posted to Ledger	25
Drawing by *A*—in Cash Book, but not posted	40
A Bought Day Book total of £1,978 posted to Impersonal Ledger as	1,879

N. From the following Trial Balance of Cutworth & Evans as at 30th June 19.., prepare Trading and Profit and Loss Accounts and Balance Sheet.

	£	£
Stock (1st January, 19..)	3,360	
Sales		10,300
Returns	310	230
Discounts	120	156
Rents	120	
Rates and Taxes	50	
Wages	830	
General Expenses	180	
Purchases	6,600	
Carriage	98	
Salaries	390	
Machinery and Plant	1,400	
Bad Debts	60	
Creditors		3,100
Debtors	2,550	
Bank	284	
Cash	70	
Capital :—		
C. Cutworth		1,250
E. Evans		1,386
	£16,422	£16,422

Stock at 30th June, 19.., £2,154. Allow 10% per annum depreciation on machinery. Create a reserve of 2½% for Bad and Doubtful Debts. Credit partners with 5% per annum on capital. The profits are shared equally.

O. In the firm of *E. & F*, *E* is a general and *F* a limited partner. To the capital of the firm, which amounts to £25,000, *F* has contributed £5,000, and out of the profits is entitled to receive interest at the rate of 8% per annum, and one-tenth of the remaining profits *E* is entitled on account of his share of the profits to draw £100 a month. At the end of the first year the following figures are extracted from the books of the firm :—

	£
Capital Account, *F*	5,000
,, ,, *E*	20,000
Creditors	10,500
Debtors	8,000
Land and Buildings	13,500
Plant and Machinery	7,500
Stock and Stores	10,500
Cash	2,400
E, Drawings Account	1,200
F, ,, ,, Interest	400
Profit and Loss Account	8,000

From these figures draft a Trial Balance and prepare accounts showing the profits due to each partner and the position of their accounts before the balance of profits respectively due is paid out.

P. Bond and Russell are in partnership as manufacturers of rubber heels and tyres. Profits and losses are shared as follows: Bond, 2/3rds; Russell, 1/3rd.

The following Trial Balance was extracted from the books of the firm as on 31st December, 19..

	£	£
J. B. Bond, Capital Account		16,000
„ Drawings Account	850	
H. Russell, Capital Account		12,000
„ Drawings Account	600	
Office Salaries	1,986	
Machinery and Plant	12,840	
Stock at beginning of year	7,294	
Purchases	29,262	
„ Returns		429
Sales		57,214
„ Returns	321	
Loan on Mortgage		8,500
Manufacturing Wages	12,314	
Travellers' Salaries and Commission	3,276	
Factory Fuel and Lighting	428	
Office Coal and Lighting	28	
Interest Account (Loan on Mortgage)	425	
Office Expenses	294	
Carriage Inwards	431	
Carriage Outwards	342	
Discount Account		78
Reserve for Bad Debts as at beginning of year		250
Freehold Factory	12,750	
Office Rent and Rates	271	
Factory Rates and Insurance	222	
Office Furniture	500	
Machinery Repairs	398	
Royalties paid on Patent Tyre Process	471	
Bad Debts	219	
Sundry Debtors	6,284	
„ Creditors		1,721
Cash in Hand	327	
„ at Bank	2,273	
Bills Receivable	1,786	
	£96,192	£96,192

You are required to prepare Trading and Profit and Loss Accounts for the year ended 31st December, and a Balance Sheet as on that date.

Before preparing these accounts, the following adjustments must be made:—

(*a*) Partners are entitled to 5% interest on capital, but no interest is to be charged on drawings.

(*b*) The following depreciations are to be provided for: Machinery and Plant, 10%; Office Furniture, 5%.

(*c*) The stock on hand, at the end of the year, was valued at £8,721.

(*d*) The provision for Bad Debts is to be increased to £400.

(*e*) H. Russell is to be credited with £500 as a partnership salary prior to the division of profits.

(*f*) The Machinery and Boiler Insurance Co., Ltd., is liable for £240 (included in "Machinery Repairs"), representing the cost of repairs necessitated by an accident to the main engine which was insured with the Company

(*g*) At the end of the year the following liabilities were outstanding: Wages, £321, Salaries, £92.

Q. Owing to two amounts being placed on the wrong sides of the following Trial Balance the casts do not agree. (1) Correct the errors; (2) prepare Trading and Profit and Loss Accounts, and Balance Sheet as at 31st December.

	£	s.	d.		£	s.	d.
Stock at 1st Jan.	1,072	19	4	Sales	10,462	2	1
Purchases	4,852	17	5	Discounts	141	14	11
Wages	1,471	16	8	Loan Account	1,500	0	0
Rent, Rates, and Taxes	100	0	0	Sundry Debtors	4,176	15	4
Salaries	800	0	0	Capital:—			
General Expenses	86	13	3	Jones	1,000	0	0
Discounts	56	9	0	Smith	1,630	1	0
Plant and Machinery	1,500	0	0	Reserve for Doubtful			
Sundry Creditors	2,036	9	0	Debts	280	0	0
Horses and Vans	742	18	3				
Cash at Bank	467	17	3				
Smith's Drawings	650	0	0				
Jones' „	500	0	0				
Returns Inwards	201	0	6				
Cost of Lease, 1st Jan.	371	0	0				
	£14,910	0	8		£19,190	13	4

The stock on the 31st December was £983 10s. Write off 10% depreciation on Plant and Machinery, 15% depreciation on Horses and Vans, and transfer £69 12s. 1d. from Sundry Debtors to the debit of Bad Debt Reserve Account, and increase Bad Debt Reserve Account to £350.

The lease of the premises is for eight years. Write off an amount for the current year so that by writing off a like amount annually the cost of the lease will stand in the books of the firm at *nil* by the time the lease expires.

Allow interest on the following accounts:—

5% for the year on Loan Account.

5% per annum on Smith and Jones' Capital Accounts.

Transfer five-eighths of the net profit to Smith's Capital Account, and three-eighths to Jones' Capital Account.

R. Knight & Green, merchants, are trading in partnership, sharing profits and losses in the proportions of three-fifths and two-fifths. They admit Scott into partnership on 1st January, 1940, the terms being that he shall bring in £1,500 as capital, and pay £1,000 for his share of goodwill, all the money to remain in the business. The capital of each partner, after adjustment in respect of this payment, is to be "fixed." The profits are to be shared, five-twelfths to Knight, four-twelfths to Green, and three-twelfths to Scott; interest on capital and drawings at 5%; Knight and Green guarantee all the assets (except stock) and liabilities at the date of taking over, and engage that Scott's share of the net profit shall be not less than £500 per annum. The Trial Balance on 31st December, 1940, was as follows:—

	£	£
Knight, Capital Account at 31st December, 1939		3,000
Green, Capital Account at 31st December, 1939		2,000
Scott, Capital brought in		1,500
Scott, Cash paid for Goodwill		1,000
Knight, Drawing Account	750	
Green, Drawing Account	600	
Scott, Drawing Account	500	
Stock on hand, 31st December, 1939	3,471	
Bills receivable, 31st December, 1939, dishonoured, bad	56	
Debtors	4,280	
Creditors		1,850
Carried forward	£9,657	£9,350

	£	£
Brought forward .	9,657	9,350
Bad Debts, 1939 Account	172	
Bad Debts, 1940 Account	47	
Amount paid in respect of a disputed claim, 1939 Account	220	
Purchases	6,415	
Sales		9,400
Discounts allowed, of which £85 belong to the 1939 Account	263	
Discounts received, of which £38 belong to the 1939 Account		119
Wages and Salaries	1,024	
General Expenses	726	
Cash at Bankers	168	
Cash in hand	10	
Rent, Rates, and Taxes	167	
	£18,869	£18,869

Deal with the following adjustments :—

Interest on drawings, Knight £16, Green £15, Scott £12.

Make a reserve for Bad and Doubtful Debts of $1\frac{1}{2}\%$ on the year's sales; and for discounts $2\frac{1}{2}\%$ on debts outstanding, and 2% on creditors. It was agreed that £400 of old stock (1939) should be valued at 50% of cost; the remaining stock on hand at 31st December, 1940, had cost £3,606. Prepare Profit and Loss Account for the year to 31st December, 1940, and Balance Sheet as on that date, keeping the partners' Capital Accounts and Current Accounts separate.

8. The following balances appear in the books of Messrs Guest, Coutes & Co., a firm of Engineers consisting of three partners, at 31st December, 19.. :—

	£
Stock at beginning of year	2,800
Purchases	12,600
Sales	22,000
Wages	3,000
Works Expenses	700
Salaries of Staff	800
Rent, Rates and Taxes	500
Lighting and Heating	150
Insurance	190
Office Expenses	220
Discounts Allowed	250
Bank Charges	20
Partners' Salaries	1,000
Partners' Drawing Accounts :—	
Guest, credit Balance at beginning of year . .	300
„ Drawings during year	400
Coutes, credit Balance at beginning of year . .	120
Santall, credit Balance at beginning of year . .	400
„ Drawings during year	200
Life Insurance Premiums	35
Life Policy, Surrender Value at beginning of year . .	300
Office Furniture	150
Sundry Debtors	4,000
Sundry Creditors	1,925
Bills Payable	825
Santall, Loan Account at beginning of year . . .	500
Cash at Bank	230
„ in Hand	25
Partners' Capital Accounts (in Credit) :—	
Guest	500
Coutes	500
Santall	500

Stock on hand at the end of the year was valued at £3,050. Surrender value of life policy at the end of the year was £325. Partners are chargeable with interest on their drawings at the rate of 5% per annum. Assume average date of drawings to be 30th June. Partners are entitled to interest on their capital at 5% per annum, and to share in the profits in the following proportions:—

Guest, seven-twentieths.
Coutes, six-twentieths.
Santall, seven-twentieths.

Santall is entitled to interest on loan account at 5% per annum.

You are required to prepare the firm's accounts showing the result of its trading for the year, together with Balance Sheet showing its position at 31st December, 19...

T. Crow, Pike, and Bradley are in partnership as tailors. The Trial Balance on 31st December, 19.., was as follows:—

	£	£
Crow, Capital Account 1st January, 19..		7,000
Pike " "		4,000
Bradley " "		3,000
Debtors	14,180	
Furniture and Fittings	1,218	
Stock on hand, 1st January, 19..	4,986	
Purchases, *less* Returns	12,712	
Motor Car	240	
Motor Expenses	193	
Discount allowed	603	
Commission	327	
Sales		23,862
Sales allowances, and returns	546	
Creditors		4,811
Bad Debts written off	735	
Bank Overdraft		1,064
Cash in hand	43	
Salaries and Wages	1,827	
Outworkers	2,914	
Rent	450	
Fuel and Light	78	
Audit Fees	50	
Sundry Expenses	392	
Bills Receivable	2,150	
Bills Payable		1,280
Reserve for Bad and Doubtful Debts		1,242
Legal Expenses	47	
Bank Interest	79	
Crow, Drawings	1,232	
Pike, "	747	
Bradley, "	510	
	£46,259	£46,259

Increase the reserve for bad debts to 10% on outstanding debtors and bills receivable; reduce the value of furniture and fittings to £1,150; the stock on hand, 31st December, 19.., was valued at £5,824; write 20% off motor car; reserve £250 for discounts and £120 for commission; interest on partners' drawings for the year, Crow, £28, Pike, £23, Bradley, £19, to be brought into account; the partners are entitled to interest at 5% on their capital accounts;

transfer 15% of net profits over £1,400, after charging interest on capital and drawings, to a Staff Bonus account; the partners share profits in proportion to their capitals. Prepare Trading and Profit and Loss Accounts and Balance Sheet.

U. From the following particulars, construct separate Manufacturing, Trading, and Profit and Loss Accounts for the year ended 31st December, 19..

	£
Stock of Materials on 1st January	4,800
„ „ „ on 31st December	6,280
„ „ Manufactured Goods, 1st January	6,500
„ „ „ „ 31st December	7,250
Bad Debts written off	250
Carriage and Cartage inwards	715
„ „ outwards	430
Cash Discounts allowed	190
Counting House salaries	1,260
Depreciation—Plant, Machinery, and Tools	650
„ Office Furniture	30
Drawing Office Salaries (Factory)	650
Gas and Water Factory	120
„ „ Warehouse	40
General expenses	340
Manager's Salary (three-fourths Factory, one-fourth Warehouse)	1,000
Productive Wages	12,600
Warehouse Wages	2,400
Materials purchased	18,500
Repairs—Plant, Machinery, and Tools	445
Sales	46,610
Travelling expenses	210
Travellers' Salaries and Commission	770
Rent, Rates, Taxes, and Insurance Factory	850
„ „ „ „ Warehouse	160
„ „ „ „ Office	40

V. From the following items taken from the books of a retail trader, prepare Trial Balance and Trading and Profit and Loss Accounts for the year ended 31st March, 1941, and Balance Sheet as at that date. The difference in the Trial Balance is to be held in suspense.

	£	s.	d.
Capital	8,100	0	0
Stock on 1st April, 1940	6,100	0	0
Motor Vans and Accessories	400	0	0
Bills Receivable	100	0	0
Bills Payable	885	0	0
Freehold Premises	2,000	0	0
Repairs	112	4	0
Salaries	1,730	0	0
Cash at Bank and in Hand	917	0	0
Rent of Warehouse	200	0	0
Sundry Creditors	2,305	0	0
Sundry Debtors	2,712	0	0
Rates	172	0	0
Bad Debts Reserve	306	12	0
Income Tax Reserve Account	90	0	0

	£	s.	d.
Sales	17,705	12	0
Purchases	14,335	8	0
Office Furniture	75	0	0
General Trade Charges	353	8	0

Stock on 31st March, 1941, amounted to £8,392, Depreciate Motor Vans, etc., by 20%, Office Furniture by 20%, and Freehold Premises by 5%. A sum of £100 is to be actually reserved for contingent liabilities.

W. Given the undernoted balances extracted from the books of a sole trader, prepare Trading and Profit and Loss Accounts for the year ended 31st December, 1940, and Balance Sheet as at that date:—

	£
Trade Debtors	19,875
Trade Creditors	14,205
Purchases	21,900
Sales	37,500
Returns (Out)	2,685
,, (In)	4,890
Discount Allowed	1,530
,, Received	1,335
Stock, 1st January, 1940	13,080
Bank Overdraft	2,370
Wages	3,570
Salaries	1,245
Carriage (In)	2,655
,, (Out)	1,260
Printing and Stationery	525
Sundry Charges	330
Bad Debts written off	120
Furniture and Fittings	800
Cash on Hand	220
Rent, Taxes and Insurance	1,890
Drawings	1,200

Trading Stock on 31st December, 1940, was valued at £14,190, and Stock of Stationery at £45. Provide a Bad Debt Reserve of £75 and a Discount Reserve of 5% on Debtors. Write off Depreciation on Furniture and Fittings at 5%. Rent and Taxes accrued at 31st December, 1940, amounted to £525, and Insurance Premiums, unexpired, to £405. During the year the proprietor had incurred travelling and out-of-pocket expenses amounting to £150, and had not been reimbursed. Overdraft interest accrued at 31st December, 1940, was £165.

X. The following Trial Balance was extracted from the books of a jeweller on 30th June, 1941. The Stock on Hand on that date was valued at £36,827. No entries have been made in the books for :

(1) One quarter's rent due, but unpaid, amounting to £250 on 30th June 1941.

(2) Travellers' Commissions due, but unpaid, on 30th June, 1941—£58.

(3) Rates for the half year to 30th September, 1941 (£368), had been paid.

(4) 10% Depreciation is to be written off the Furniture.

TRIAL BALANCE ON 30TH JUNE, 1941.

	Dr. £	*Cr.* £
Capital		30,000
Furniture and Fittings	1,900	
Stock on 1st July, 1940	32,856	
Purchases	25,356	
Carriage (Out)	77	
Sales		35,305
Salaries	500	
Wages	1,455	
Drawings	1,011	
Advertising	316	
Bills of Exchange	600	10,500
Travellers' Commission	1,310	
Rent and Rates	1,675	
Bad Debts	280	
Sundries	568	
Debtors and Creditors	8,593	3,047
Heat, Light and Insurance	374	
Stationery and Telephone	142	
Discounting Charges	53	
Receipts for Repair Work		406
Cash at Bank and in Hand	2,192	
	£79,258	£79,258

From the foregoing, prepare Trading and Profit and Loss Accounts for the year ended 30th June, 1941, and Balance Sheet as at that date.

CHAPTER VIII

THE ACCOUNTS OF LIMITED COMPANIES

INCORPORATION, CAPITAL ISSUES, AND STATUTORY BOOKS

[*Unless otherwise stated, Section references in this and the following chapter are to the Companies Act*, 1929.]

THE accounts of limited companies may be divided into three main sections, viz. :—

1. The record of the financial operations consequent upon the formation of the company, including the raising of the company's capital, and the detailed accounts of the shareholders and debenture holders ;
2. The ordinary trading or financial transactions of the company ; and
3. The appropriation or distribution of profits, the raising of reserves and sinking funds, the redemption of shares and debentures, and the compilation of the final accounts and balance sheet at the close of the trading period.

The present chapter deals essentially with the first section ; the ordinary trading or financial transactions differ but little from those of a sole trader or partnership, and are adequately dealt with in other parts of this work, while consideration of the third section is deferred to the following chapter.

Classes of Companies.

A company may be incorporated—

1. By Royal Charter (or letters patent), e.g., The Royal Mail Steam Packet Company.
2. By special Act of Parliament, e.g., railway companies, etc.
3. By registration under the Companies Act, 1929.

The Companies Act, 1929, which came into operation on 1st November 1929, constitutes the basis of the law relating to registered companies.

A company is a separate *legal persona* quite distinct from its members, and the main differences between a registered company and a partnership, as summarised below, should be carefully noted.

Registered Company.	Partnership.
(a) Members merely as such are not entitled to share in the management.	(a) In the absence of express agreement to the contrary, all general partners are entitled to share in the management.
(b) The individuality of the members is lost in the new entity established by law.	(b) The individuality of the partners is not entirely lost.
(c) In a public company the number of members may consist of 7 or more; and in a private company, of from 2 to 50. (This maximum is exclusive of employees and ex-employees.)	(c) No partnership formed for the purpose of carrying on business for gain can be established if it consists of more than 20 persons (or in banking business, 10).
(d) Members as such have no power to bind the company.	(d) A partner is, in the ordinary course, entitled to enter into contracts on behalf of the partnership firm.
(e) The liability of a member is limited to the amount (if any) unpaid on his shares or to the amount for which he originally agreed to be liable.	(e) Except in the case of a limited partner the liability of a partner extends, not only to his share of the partnership assets, but to his private estate as well.
(f) Profits not distributed as dividends cannot be added to the share capital (except when capitalised by the issue of bonus shares); and share capital can only be reduced after compliance with various statutory formalities.	(f) Subject to any contrary agreement, a partner's share of profits may be added to his capital, and his drawings may be deducted therefrom.
(g) The accounts must be audited periodically.	(g) The accounts are only audited if, and to the extent that, the partners desire.

Kinds of Registered Companies.

Companies registered under the Companies Act, 1929, may be—

1. Unlimited; or
2. Limited by guarantee; or
3. Limited by shares.

In unlimited companies, which are now very rarely found, every member is liable for the debts of the company as in an ordinary partnership, but such liability extends for only one year after he has ceased to be a member.

Guarantee companies are usually formed for the furtherance of art, religion, charity, or professional objects, and not, as a rule, for purposes of profit. Each member guarantees to contribute an amount not exceeding a fixed sum to meet the company's liabilities in the event of a winding up whilst he remains a member, or within twelve months afterwards, for debts incurred prior to the cessation of his membership.

Most companies are "limited by shares," and the liability of a member is strictly limited to that part of the nominal amount of his shares which has not already been paid up; this principle of "limited liability" is the important feature of these companies.

Number of Members.

Registered companies can be further sub-divided into public and private companies.

A public company may consist of any number of members, not less than seven. Any association consisting of more than twenty persons (ten in a banking business) carrying on business for profit must be registered or incorporated as a company (Sections 357-8). A private company may consist of any number of persons not less than two or more than fifty (excluding members who are employees or ex-employees).

If the number of members is reduced below the minimum, this is a ground for compulsory winding up, and if a company carries on business for more than six months after the number of its members has been reduced below the minimum, every member cognisant of the fact is personally liable, without any limitation, for the whole of the company's debts contracted after such six months (Section 28).

Private Companies.

By Section 26, a private company is defined as one which, *by its Articles,*

(*a*) Restricts the right to transfer its shares ;
(*b*) Limits the number of its members (exclusive of employees or ex-employees) to fifty ; and
(*c*) Prohibits any invitation to the public to subscribe for any shares or debentures of the company.

Any company which is not a private company, as defined above, is a public company.

Section 27 provides that a private company which alters its Articles so that they cease to include any of the above matters, shall cease to be a private company as on the date of the alteration, and must, within fourteen days after that date, file with the Registrar of Companies a prospectus or statement in lieu thereof.

PRIVILEGES OF A PRIVATE COMPANY. In the case of a private company—

(1) The annual return (see page 279) need not include a copy of the last balance sheet and auditor's report.
(2) Holders of debentures have no legal right to inspect balance sheets and reports.
(3) Only two members are necessary to enable the company to carry on business.
(4) The company is not liable to be wound up because it has less than *seven* members, but it is a ground for liquidation if the number of members falls below *two*.
(5) No statutory report (see page 304) need be filed, nor need a statutory meeting be held.

(6) The directors may act without having filed their consent to act in that capacity or signed the Memorandum or a contract for their qualification shares.
(7) No statement in lieu of prospectus need be filed.
(8) No minimum subscription (see p. 284) is required before proceeding to allotment or commencing business.
(9) Copies of the balance sheet and auditor's report need not be furnished gratis to members.

Memorandum and Articles of Association.

Both public and private companies must, upon their incorporation, file certain documents with the Registrar of Companies. The principal and most important of these are the Memorandum of Association, and the Articles of Association.

THE MEMORANDUM OF ASSOCIATION defines the powers of the company with regard to its dealings with the outside world. In the case of a company limited by shares, the clauses in the Memorandum must state :—

(1) The name of the company, with "Limited" as the last word.
(2) Whether the registered office is to be situate in England or in Scotland.
(3) The objects of the company.
(4) That the liability of members is limited.
(5) The nominal amount of share capital and the division thereof into shares of a fixed amount.

To these clauses is added a "subscription clause," expressing the desire of the signatories for the formation of the company, and indicating opposite each signature the number of shares each signatory agrees to take.

THE ARTICLES OF ASSOCIATION are the regulations which govern the internal management of the company's affairs, and state the duties, rights, and powers of the members as between themselves and the company in general. Companies which are limited by guarantee or unlimited, and private companies, must register the Articles of Association with the Memorandum, but a public company limited by shares may either register special Articles or adopt Table A of the First Schedule to the Companies Act, 1929. This Table is a model set of Articles consisting of 107 clauses, and if it is adopted the Memorandum is endorsed "Registered without Articles of Association," and Table A then applies. The regulations of Table A apply in every case in so far as they are not modified or expressly excluded by the Articles. Small companies frequently adopt part of Table A, so far as it is applicable to their business, and register Articles to that effect. A private company *must* register special

Articles in order to include the three restrictions enumerated on page 269. The Articles must be printed, must bear a ten-shilling deed stamp, and must be signed by the subscribers to the Memorandum. Every member of the company is entitled to a copy of the Memorandum and Articles upon payment of a sum not exceeding one shilling.

Persons dealing with the company are bound to ascertain, and will be deemed to have notice of, any limitations in the Articles, as the Memorandum and Articles, when registered at Bush House, become public documents, which any person may inspect on payment of a small fee. This is directly opposite to the rule in regard to articles of partnership, as persons dealing with the firm are bound only by limitations of which they have actual notice or which are apparent from the circumstances or from the conduct of the parties.

Share Capital.

The Memorandum contains particulars of the company's total nominal share capital, upon which it has to pay an *ad valorem* capital duty at the rate of 10s. per cent. (reduced from £1 per cent. as from 26th April, 1933), in addition to certain fee and deed stamps. The amount is usually stated in the following or similar manner :—

> "The Share Capital of the Company is £105,000, divided into 50,000 Preference Shares of £1 each ; 50,000 Ordinary Shares of £1 each, and 100,000 Deferred Shares of One Shilling each."

It is not necessary that the whole of this nominal or authorised capital shall be issued at the outset, or that the whole amount of each share shall be fully paid up.

The various terms used in connection with share capital are :—

(1) NOMINAL OR AUTHORISED CAPITAL, i.e., the amount which a company takes power, in its Memorandum, to issue.

(2) SUBSCRIBED OR ISSUED CAPITAL, i.e., the total nominal value of the shares allotted to members.

(3) CALLED-UP CAPITAL, i.e., the total amount of the subscribed capital which has actually been called up by the directors.

(4) PAID-UP CAPITAL, i.e., the total amount paid up, or credited as paid up, on the issued share capital.

(5) UNCALLED CAPITAL, i.e., the total amount which has not been called up on the issued share capital.

(6) UNISSUED CAPITAL, i.e., that portion of the nominal capital which has not been allotted to members.

(7) Reserve Capital, i.e., that portion of the issued share capital which the company has resolved, by special resolution, can be called up only in the event of the company being wound up.

Working Capital is a term used to represent the excess of the floating assets of a company over its current external liabilities, and must not be confused with any of the above terms used in connection with the share capital of a company.

Watered Capital is a term used to represent capital, the nominal value of which has been inflated (e.g., by an issue of bonus shares to the shareholders [see page 371], or by the payment of an excessive price for goodwill when a company takes over a private business). Thus the amount of the issued capital has been increased without a corresponding increase in the amount of the assets.

Loan Capital is a term frequently applied to debentures and other loans. Such loans constitute liabilities of the company to the persons lending the money, and do not form part of a company's share capital.

Shares.

A share is a fixed part of the company's share capital. From a legal point of view, however, a share may be defined as the interest which a shareholder has in a company, and it is measured by a sum of money for the purpose of (1) computing the shareholder's liability, and (2) ascertaining the amount of the shareholder's dividend, i.e., his proportionate part of the profits. The issue of a share certificate is *prima facie* evidence that the person named thereon is the owner of the shares set out in the certificate.

The three principal classes of shares are Preference, Ordinary and Deferred shares, but there are many variations of these; the following list includes the classes most frequently encountered:—

(1) Preference.
(2) Cumulative Preference.
(3) Participating Preference.
(4) Redeemable Preference.
(5) Ordinary.
(6) Preferred Ordinary.
(7) Deferred Ordinary.
(8) Deferred.
(9) Founder's.

The respective rights and privileges attaching to each class of share are determined by the provisions of the Memorandum and Articles of Association, but the more usual features of the above classes of shares may be summarised thus:—

(1) Preference Shares are those which confer some preferential right over other classes of shares, usually the right to a fixed dividend out of the profits of each year before any dividend is paid to the holders of ordinary shares. In many cases, the

additional right to a return of capital in priority to other classes is also given.

(2) CUMULATIVE PREFERENCE SHARES entitle the holder to a dividend at a fixed rate, such dividend being payable out of future profits when the current year's profits are insufficient. All arrears of dividend on these shares must be paid before the other shareholders can participate in the profits. Unpaid cumulative preference dividends are not liabilities in the ordinary sense; the liability is contingent upon the company earning sufficient profits out of which to pay the dividends and upon the declaration of the dividend. Moreover, the directors are usually authorised by the Articles to transfer a part, or even the whole of the profits to reserve before payment of any dividends.

Preference shares are assumed to be cumulative if the contrary is not clearly shown in the Memorandum or Articles of Association.

(3) PARTICIPATING PREFERENCE SHARES usually confer the right to a fixed dividend, and, in addition, entitle the holder to participate in surplus profits (if any) after the Ordinary Shareholders have received a dividend at a stated rate.

(4) REDEEMABLE PREFERENCE SHARES may be issued by a limited company if authorised by its Articles. Such shares may be cumulative, non-cumulative, or participating, according to the terms of issue, but the power of redemption is subject to the following conditions:—

(*a*) The shares are to be redeemed only out of profits available for dividend, or out of the proceeds of a fresh issue of shares made for redemption purposes;

(*b*) The shares are not to be redeemed unless they are fully paid;

(*c*) Where shares are redeemed out of profits there must be transferred to a "Capital Redemption Reserve Fund," out of profits otherwise available for dividend, a sum equal to the amount applied in redeeming the shares. The provisions of the Act as to reduction of capital apply to this fund as if it formed part of the paid-up share capital.

(*d*) Where shares are redeemed out of the proceeds of a fresh issue, any premium payable on redemption must be provided for out of the profits of the company before the shares are redeemed.

Where shares are redeemed or are about to be redeemed under the above provisions, the company may issue further shares of equal nominal value to those redeemed, without incurring any further liability for stamp duty in respect of the new issue, provided that the redemption takes place within one month after the fresh issue.

On an issue of further shares the company may apply out of the Capital Redemption Reserve Fund an amount equal to the nominal amount of the shares so issued, in paying up unissued shares of the company to be issued to members as fully-paid bonus shares.

Every Balance Sheet of a company which has issued redeemable preference shares must contain a statement specifying what part of the issued capital of the company consists of such shares and the date on or before which those shares are, or are liable, to be redeemed (Section 46).

(5) ORDINARY SHARES are those which, as a general rule, are entitled to the whole of the surplus profits after satisfaction of the rights of Preference Shareholders. Except where Participating Preference or Deferred Shares are issued, no fixed rate of dividend on Ordinary Shares is stated.

(6) and (7). The Ordinary Shares are sometimes split into two sub-classes, PREFERRED ORDINARY and DEFERRED ORDINARY. The holders of the former class of share have a prior right to a fixed non-cumulative dividend, and until this dividend is paid the holders of Deferred Ordinary Shares do not participate in the distribution of profits.

(8) and (9). DEFERRED OR FOUNDER'S SHARES are those which rank for dividend after all the other classes have received fixed rates of dividend. They are usually issued as fully paid to the original vendors or their nominees in satisfaction of part of the purchase price of the business, or for services rendered in the formation of the company. These shares are generally of small nominal value, and as they receive a considerable proportion of the surplus profits after the dividend on the ordinary shares has reached a fixed rate and usually carry extensive voting powers, such shares are extremely valuable when the business is successful.

When an existing business is formed into a limited company, the vendor is sometimes paid in cash or Ordinary Shares for the tangible assets, while that part of the purchase price which is in respect of the goodwill is satisfied by the allotment of Deferred Shares. Since goodwill may be regarded as the capitalised value of the future "super profits" of the business (see page 187), the anomalous position may arise that the vendor, while purporting to sell the goodwill of the business, virtually retains the benefit of that asset, in the shape of the dividends paid on his Deferred Shares out of future surplus profits.

Shares Distinguished from Stock.

In many respects stock and shares are identical; each confers upon the holder exactly the same rights and privileges,

and in fact, stock has been legally defined as " a set of shares put together in a bundle." Shares, however, may be partly paid, while stock must be fully paid; again, each share must possess a distinctive number (Section 62), while stock cannot be so numbered.

Shares and stock are ordinarily transferable in the same manner, but while fractions of a share cannot be transferred, stock may be transferred in any amount, from 1d. upwards, subject to any restrictions imposed by the company's regulations. Public companies usually stipulate that stock is transferable only in amounts of a stated number of pounds sterling—e.g., £10—or multiples thereof.

Stock cannot, however, be issued in the first instance, except by Statutory Companies which are governed by their own special Acts of Parliament (see Chapter XVII); a limited company must first issue shares, and when these are fully paid, may convert them into stock, provided the company's Articles contain the requisite authority (Section 50).

Stock may be sub-divided into several classes in the same way as shares.

Share Warrants.

A public company, if so authorised by its Articles, may issue share warrants to bearer in respect of any fully-paid shares or stock, and may provide by coupons or otherwise, for the payment of the future dividends on the shares or stock included in the warrant. The shares enumerated in the warrant are transferable by mere delivery of the warrant, and consequently cannot be issued by a private company, which must, by its Articles, restrict the right to transfer its shares.

Table " A " of the Companies Act, 1929, makes no provision for the issue of share warrants.

Management of the Company.

A public company registered after the commencement of the Act must have at least two directors, but the management of every company is usually entrusted to directors, who are generally required to be shareholders in the company. The powers and duties delegated to the directors are generally outlined in the company's Articles of Association; their precise status, however, is somewhat difficult to define, as so much depends upon the aspect from which their position is viewed. Directors have been variously described as :—

(1) Trustees of the company's moneys and property;
(2) Agents in respect of the transactions into which they enter on behalf of the company; and
(3) Managing partners.

The directors, as trustees, occupy a fiduciary position, and they must not personally make profits out of the company without the sanction and approval of the members of the company. They must disclose at a directors' meeting any interests they have in contracts or proposed contracts with the company. As agents for the company the directors do not incur any personal liability on the company's contracts, if made within the scope of their authority.

The term "managing partners" is not strictly applicable, for although the directors do in fact manage the business of the company on behalf of themselves and of their fellow members, they are not "partners" within the meaning of the Partnership Act, 1890.

Directors are not entitled to any remuneration except as provided by the Articles of the company, which usually reserve the power for the shareholders to determine the remuneration by resolution in general meeting.

The Act contains several provisions designed to secure proper disclosure of payments and loans made to directors.

Section 128 provides that the accounts which are laid before the company in general meeting, must contain particulars showing :—

(a) The amount of any loans made to any directors or officers of the company during the period to which the accounts relate either by the company or by any other person under a guarantee from or on a security provided by the company.

(b) The amount of any such loans repaid during the period.

(c) The amount of any such loans made prior to the aforesaid period which are still outstanding at the expiration of the period.

(d) The total amount paid to directors as remuneration for their services, inclusive of all fees, percentages or other emoluments paid to or receivable by them by or from the company or by or from any subsidiary company.

The above provisions as to disclosure of loans to directors and officers of the company apply to both public and private companies but do not apply where :—

(a) The ordinary business of the company includes the lending of money, and the loan is made in the ordinary course of business ; or

(b) The loan does not exceed £2,000 and is made to an employee, provided that such loan is certified by

the directors as being in accordance with any practice adopted or about to be adopted by the company with respect to loans to employees.

Furthermore, in computing the total amount of directors' remuneration disclosed there need not be included the amounts paid to a managing director, nor the salary payable to any other director holding a salaried office in the company, except sums paid by way of directors' fees.

EXAMPLE 1.

A limited company, which makes up its accounts to 31st December each year, has three directors, *A*, *B* and *C*. Details of the loans made to these directors are as follows :—

Amounts owing at 31st December, 1939—*A*, £2,000 ; *B*, £1,500.
Loans made during 1940—*B*, £1,000 ; *C*, £1,250.
Loans repaid during 1940—*A*, £1,000 ; *C*, £500.

The following details would appear in the company's Balance Sheet at 31st December, 1940 :—

Assets (include)

Loans to Directors—	£	£	£
Made during year	2,250		
Less repaid	500		
	——	1,750	
Made prior to current year and still outstanding .		2,500	
		——	4,250

[It will be noted that, although the amount of the loans made *and* repaid during the period must be specified, there is no necessity to specify the extent to which loans made prior to the current period have been repaid during the period. This information can be ascertained by comparing the details set out in consecutive Balance Sheets.]

EXAMPLE 2.

During the year ended 30th June, 1941, X.Y. Ltd. makes the following payments to its directors as remuneration for their services :—

A (Director's Fee, £100).
B (Managing Director's Salary, £300 ; Director's Fee, £50).
C (Secretary's Salary, £250 : Director's Fee, £100).

The amount required to be disclosed separately in the annual accounts of X. Y. Ltd., in order to comply with the provisions of the Companies Act, is £200, made up of :—

	£
A—Director's Fee	100
C.— „	100
	£200

It will thus be seen that :—

(*a*) It is not necessary to disclose *any* sums paid to a *managing director*.
(*b*) When a director (other than a managing director) holds a salaried office or employment in the company, only the sum paid to him by way of *director's fee* need be disclosed.

The salary paid to *C* as secretary, and the whole of the remuneration paid to *B*, the managing director, may be charged in the accounts along with general salaries.

On a demand made in writing by members entitled to not less than one-fourth of the voting power of the company, all

members must be furnished with a statement showing the aggregate remuneration paid to directors during each of the last three preceding years, including sums received by a director for acting as a director of a subsidiary company. This statement includes *all* remuneration paid to directors (without any exceptions) and it must be certified as correct, with any necessary qualifications, by the auditors of the company (Section 148).

There must further be disclosed to and approved by the company, all payments to directors by way of compensation for loss of office or on retirement, where such payments are made in connection with the transfer of the whole or any part of the undertaking or property of the company (Section 150).

Statutory Books.

The following books are required by statute to be kept by a limited liability company :—

REGISTER OF MEMBERS. This contains a list of the names, addresses, and occupations of all members of the company, together with a statement of the shares held, their distinctive numbers, and the amount paid or agreed to be considered as paid on each. The date at which each person was entered in the Register as a member must be given, and also the date when membership ceased (Section 95). A specimen page of the usual form of this book is given on page 307.

Section 96 provides that companies with more than fifty members must keep an index of the names of members, unless the register itself is in such a form as to constitute an index. The index may be in the form of a card index, and must be kept up to date.

This register, including the Annual Return, which must be contained in a separate part of the register, is open to the inspection of members free of charge, and of other persons at a fee not exceeding one shilling for each inspection. Moreover, any person may acquire a copy of the register, or of any part thereof, on payment of a fee not exceeding sixpence per hundred words.

REGISTER OF DIRECTORS. A register containing the present and former names, addresses, nationality, nationality of origin (if other than the present nationality) and occupation, and other directorships of each director and manager of a limited company, must be kept at the registered office (Section 144).

REGISTER OF MORTGAGES. This consists of a statement of all mortgages and charges specifically affecting the property of the company and all floating charges on the undertaking or any property of the company, together with names of the mortgagees, the amount of the charge, and a short description of the property charged. In addition, it is usual to give the date of the creation of the mortgage and the date of its discharge (Section 88). The

Register of Mortgages may be inspected free of charge by any member or creditor of the company, and by any other person for such fee not exceeding one shilling, as the company may fix. Refusal to permit such inspection renders the officer refusing the inspection, and any director authorising or knowingly permitting the refusal, liable to a fine of £5, and a further fine of £2 per day during the continuance of the refusal (Section 89).

Every company must keep at its registered office a copy of every instrument creating any charge requiring registration, though in the case of a series of uniform debentures one copy is sufficient (Section 87).

A specimen Register of Mortgages is given on page 318.

MINUTE BOOKS. Every company is required to record in special books minutes of all proceedings at general meetings (Members' Minute Book), and of all proceedings at meetings of its directors or managers (Directors' Minute Book) (Section 120). The Members' Minute Book must be kept at the company's registered office and be open to inspection by members without charge. Any member may be furnished with a copy of such minutes at a charge not exceeding sixpence per hundred words.

ANNUAL RETURN. This must be filed with the Registrar of Companies, a copy thereof being kept in a separate part of the Register of Members. It contains a list of the members of the company on the fourteenth day after the annual general meeting, and a list of all persons who have ceased to be members during the year. Names, addresses, and occupations must be given, as in the case of the Register of Members, together with the number of shares held and the number transferred during the year. If the names are not in alphabetical order an index must be attached. In addition, a summary of capital, etc., is required, giving detailed information as specified in the Sixth Schedule to the Act. The Annual Return of a public company must also include certified written copies of the last audited Balance Sheet and of the auditor's report, and any other document required by law to be annexed thereto.

It is necessary for a limited company to make the following returns to the Registrar of Companies :—

(1) Return of Allotments—within one month after any allotment of shares (Section 42). Any default in respect of this return renders every director and officer who is knowingly a party thereto liable to a fine not exceeding £50 per day during the continuance of the default.

(2) Annual Return. This must be made up to the fourteenth day after the annual meeting, be completed within twenty-eight days of the meeting, and filed forthwith (Section 110). If a company defaults in this matter the company and any officer who is in default is liable to a default fine.

It should be observed, however, that a printed copy of the last audited Balance Sheet, etc., will be accepted by the Registrar, provided such printed copy is certified by a director, secretary, or manager as a true copy.

A private company must file with its annual return a certificate, signed by a director or the secretary, that the company has not issued to the public any invitation to subscribe for shares or debentures, and, if the number of members exceeds fifty, a certificate stating that the excess number consists wholly of employees or ex-employees who became members while so employed.

(3) Particulars of Mortgages and Charges—within twenty-one days after creation (Section 79). Any failure to register particulars will (unless the particulars are registered by some other person) render the company, and every director, etc., who is knowingly a party to the default, liable to a fine not exceeding £50 per day, and on winding up the charge will be void, though the debt will not be thereby extinguished, the creditors being able to prove as unsecured creditors.

(4) Copy of Register of Directors or Managers—within fourteen days of appointment of the first directors and notification of any changes within a similar period (Section 144). In case of default the company and every officer of the company who is in default, is liable to a default fine, i.e., a fine of £5 per day for every day during which the default continues.

It is also necessary to file numerous documents, e.g., prospectus, copies of special and extraordinary resolutions, etc., as provided by the Companies Act.

In addition to the foregoing compulsory books, the usual financial books of account are required for the purpose of recording the pecuniary aspect of the company's trading. The legal requirements as regards books of account are dealt with on page 329. Special books are also necessary in which to record the issue of share capital and transfers of shares. The latter books include—

(1) Application and Allotment Book, in which are recorded particulars of applications received for shares, allotments made, payment of allotment money and return of application money to unsuccessful applicants.

(2) Calls Book, recording particulars of calls made on the shareholders and the amounts paid by them.

(3) Register of Transfers, recording particulars of shares transferred by members, and the names, etc., of the transferors and transferees.

A specimen ruling of the Application and Allotment Book and further reference to the Calls Book are given on page 300. For convenience, the entries are usually made on loose sheets, thus enabling several clerks to work simultaneously on the allotment (or call) sheets and the allotment (or call) letters. When the work in connection with the allotment or call is finally completed,

the loose sheets should be bound in book form as a permanent record.

The Register of Transfers is really a share journal, and forms the medium from which postings are made in the Register of Members. This book usually takes the following form :—

REGISTER OF TRANSFERS.

No. of Ts.	Transferor.		Reg of Mem. Fo.	No. of Shares.	Distinctive Nos.		Old Cert. No.	Transferee.			Reg. of Mem. Fo.	New Cert. No.	Consideration.	Remarks.
	Name.	Address.			From.	To.		Name.	Address.	Description.				

Where shares of different classes are issued, it is usual to keep separate registers for each class of share.

Borrowing Powers and the Issue of Debentures.

A trading company has an implied power to borrow money and to issue debentures. In the case of other companies the Memorandum and Articles must provide for a power to borrow upon debentures; otherwise a special resolution is necessary before debentures can be issued.

Debentures.

A Debenture is a bond, acknowledging a loan, usually under the company's seal and secured by a charge on the company's property or undertaking, bearing a fixed rate of interest, and being either repayable within a specified period or irredeemable during the existence of the company. The main difference between debentures and debenture stock is with regard to transfer. A debenture must be transferred in its entirety; debenture stock may be transferred in whole or in part, but the Articles often provide that any transfer must not involve a fraction of a specified amount. Debentures may be—

(1) Mortgage debentures, giving a charge upon the whole or a part of the company's assets; or

(2) Simple or Naked Debentures which are a mere promise to repay, unsecured by any charge.

Debentures may also be classified as—

(1) Debentures payable to a registered holder (with or without interest coupons payable to bearer); and,

(2) Debentures payable to bearer simply (with or without power for the bearer to be registered as holder).

Debentures to bearer must be stamped on issue at the rate of 4s. for every £10, or part of £10, on the amount secured; on any subsequent transfer no further stamp duty is payable. Registered debentures must be stamped on issue at the rate of 2s. 6d. per cent., and if redeemed and subsequently réissued, they must be restamped as if they were new debentures (Section 75).

Section 75 (1) provides that a company may re-issue debentures which have been redeemed, unless the Articles or the terms on which the debentures were issued forbid re-issue, or the company has, by resolution or otherwise, manifested its intention to cancel the redeemed debentures. Persons to whom such re-issued debentures are issued have the same rights and priorities as if the debentures had never been redeemed, i.e., they are entitled to rank *pari passu* with the original debenture holders. Particulars of debentures which have been redeemed and can be re-issued must be included in every Balance Sheet of the company.

Transfer of Debentures.

Debentures to bearer have been declared to be negotiable instruments, and are therefore transferable by simple delivery.

Registered debentures and debenture stock, being expressed to be payable to the registered holders, must be transferred in the same manner as shares or stock, and the transfer instrument must be registered with the company.

Section 63 provides that no company may register a transfer of shares or debentures unless a properly executed instrument of transfer is delivered to the company, except where such transfer is by operation of law (e.g., death or bankruptcy). This applies in spite of any provision to the contrary in the Articles.

Mortgage Debentures.

Debentures may have a specific charge on certain assets of the company. Such a charge is usually created by means of a mortgage of the assets to trustees with a trust deed. The deed will set out the rights of the trustees to act on behalf of the debenture holders when it is necessary to protect their security. The trustees will usually have possession, on behalf of the debenture holders, of the documents of title to the assets covered by the charge, in order to prevent the company from dealing with the assets or creating further charges thereon.

Floating Charges.

Debentures may be issued which carry a "floating charge," in which case all the company's assets and undertaking (or such assets as are not subject to a specific charge) are charged with the repayment of the debentures, but the company is entitled to deal with such assets in the ordinary course of business until the charge "crystallises" (i.e., becomes fixed), which occurs if a winding-up order is made, or if the money becomes repayable in accordance with the terms of the debentures, and the debenture holders take steps to realise their security, as by getting a receiver appointed to act on their behalf.

Registration of Debentures.

(1) A company must keep a register of all mortgages and charges, including floating charges, specifically affecting its property (Section 88). A specimen ruling is given on page 318.

(2) The Registrar of Companies keeps a public register of mortgages and charges (Section 82).

(3) A company issuing debentures usually keeps in addition a register of debenture holders, and a register of debenture transfers, in similar manner to the register of members and register of share transfers.

Debentures secured by a mortgage or charge must be registered with the Registrar as well as in the register kept by the company.

Debentures do not require to be registered as bills of sale

Issue of Capital.

After the registration of the company is effected, the first important step is to obtain the capital with which the company will commence trading. In the case of private companies, this is usually subscribed by the signatories to the Memorandum and Articles and their relatives and friends. For public companies, however, the more general method is to issue a prospectus inviting the public to take up the shares, although the directors and their friends often subscribe for a large proportion of the shares offered for subscription.

The prospectus sets forth particulars of the company, its directors and other officials, its business, and an estimate of its future prospects, and the amount and nature of the capital offered for subscription. In addition to much other information, it further states the amount of deposit payable upon application for shares; the amount payable upon allotment; and whether further instalments are payable on stated dates or when "called"

by the directors. An application form is attached, usually with directions that it should be forwarded with the application money direct to the company's bankers.

Where the company has been in existence for some time, an auditor's report of the company's profits must also be set out in respect of each of the three financial years immediately preceding the issue of the prospectus, and of the rate of dividends paid in respect of each class of shares during each of the said three years; and, if the proceeds or any part thereof are to be applied in the purchase of a business, an accountant's report of the profits of such business during each of the three financial years immediately preceding the issue of the prospectus.

There must further be disclosed the minimum amount which, in the opinion of the directors, must be raised to provide for—

(a) The purchase price of any property which is to be defrayed out of the proceeds of the issue;

(b) The preliminary expenses and commissions payable to persons for taking or placing shares;

(c) The repayment of any money borrowed by the company in connection with (a) and (b); and

(d) The working capital.

In the case of a public company no shares may be allotted unless at least three days before allotment a statement in lieu of prospectus is filed with the Registrar unless a prospectus is issued and has been so filed, and the aforementioned minimum amount has been subscribed and at least 5 per cent. of the nominal value of each share applied for has been paid in cash or by cheque. In calculating these amounts, shares payable otherwise than in cash are excluded.

If the minimum subscription is not obtained within 40 days of the issue of the prospectus, the application moneys must be returned to the senders; if not returned within 48 days, the directors are liable to repay the money with interest at 5 per cent. per annum from the expiration of the 48th day.

Allotment of Shares.

The entries required to record the issue of any class of shares, and of debentures or debenture stock, are similar, and may be summarised in the following manner:—

The applicant fills up the application form and forwards it, with a remittance for the deposit payable (which, in the case of shares, must be at least 5 per cent of the nominal value), direct to the company's bankers.

The sums received with the applications are recorded in detail by the bank in a special pass-book, which is obtained from the bank periodically (usually daily) by the secretary of the company. The deposits received are entered in detail on the debit side of the company's Cash Book, from which they

are posted, usually in daily totals, to the credit of the Application and Allotment Account.

Detailed particulars of the allottee (name, address, description, number of shares applied for, deposit paid, etc.) are also entered on Application and Allotment Sheets, and, in due course, these sheets and the application forms are submitted to the directors at a board meeting. The directors then decide the number of shares (if any) to be allotted to each applicant. Their decisions are recorded on the application and allotment sheets, which are then signed or initialled by the chairman.

The secretary prepares and issues to the allottees the " Letters of Allotment " ; these letters state the number of shares allotted to the applicant, and request payment of the amount due on allotment. After the allotment letters are posted, a legally binding contract is formed between the company and the applicants, who are bound to take up and pay for their shares in accordance with the terms of the prospectus. Allotment letters are subject to a stamp duty of sixpence (impressed) where the nominal value of the shares is £5 and upwards. For values under £5 the duty is one penny only.

Where the company's offer is very attractive to investors, applications may be received for more shares than the company offers for subscription. In such cases the deposit money is returned to each unsuccessful applicant accompanied by a " Letter of Regret." Where an allottee receives a smaller number of shares than he applied for, the surplus portion of the amount paid on application is applied in satisfaction, either in whole or in part, of the amount due on allotment. If the amount received on application exceeds the total due on application and allotment the surplus is returned to the allottee. Upon allotment, a journal entry is made, debiting the Application and Allotment Account and crediting the Share Capital Account with the total amount payable on application for and allotment of the shares issued ; while the amounts refunded to the unsuccessful applicants are credited in the Cash Book and debited to the Application and Allotment Account. The latter account is credited with the amounts paid on allotment, cash being debited.

When all the allottees have paid the whole of the amounts due on allotment, the Application and Allotment Account will be closed ; the debit entries for the amounts due, together with the debits for the amounts refunded to unsuccessful applicants, equalling the credit entries for cash received from applicants and allottees.

EXAMPLE.

The Advance Company, Ltd., makes an issue of 100,000 Ordinary Shares of £1 each, payable 5s. on application, and 15s. on allotment. Applications were received on Jan. 12th for 250,000 shares. On Jan. 15th the Company went to allotment; the application moneys received from the applicants for 60,000 shares were returned to them, and the excess application moneys received from the remaining applicants were carried forward in part satisfaction of the amounts

due on allotment on the shares allotted to them. The balance of the allotment moneys was received on Jan. 18th.

Record the above transactions in the Journal of the Advance Company, Ltd.

JOURNAL.

			Dr.	Cr.
19..			£	£
Jan. 12	Cash . . . . *Dr.* To Application Account [See Note (1)] *Being amounts paid by sundry applicants on applications (5s. per share) for 250,000 Ordinary Shares of £1 each.*		62,500	62,500
Jan. 15	Application Account . . . *Dr.* Allotment Account . . . . „ To Ordinary Share Capital Account . *Being amounts payable per share on application (5s.) and allotment (15s.) on 100,000 Ordinary Shares, Nos. 1 to 100,000, allotted this day. (Vide Minute Book, Resolution No. . . .)*		25,000 75,000	100,000
Jan. 15	Application Account . . . *Dr.* To Cash . . . . *Being return of application moneys to unsuccessful applicants for 60,000 shares.*		15,000	15,000
Jan. 15	Application Account . . . *Dr.* To Allotment Account . . . *Being application moneys on 90,000 shares, carried forward in part satisfaction of allotment moneys due on shares allotted.*		22,500	22,500
Jan. 18	Cash . . . . *Dr.* To Allotment Account . . . *Being receipt of balance of allotment moneys.*		52,500	52,500

NOTES.—(1) Separate Application Account and Allotment Account have been opened, in order to show the exact effect of setting off excess application moneys against amounts due on allotment. In the normal way it is sufficient to open a single account—the Application and Allotment Account—the entries in which would have been :—

Dr. APPLICATION AND ALLOTMENT ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 15	To Share Capital A/c.		100,000	Jan. 12	By Cash on Application . .		62,500
„ 15	„ Cash returned to unsuccessful applicants . . .		15,000	„ 18	„ „ on Allotment		52,500
			£115,000				£115,000

the transfer between Application Account and Allotment Account thus being cancelled out. In answering examination questions, the use of a combined

Application and Allotment Account is recommended, except where it is desired to show the transfer of excess application moneys to Allotment Account. Furthermore, it should be noted that the Application and Allotment Account can be regarded as a "Sundry Shareholders Account" recording the amounts owing by, and received from, the shareholders

(2) The SEQUENCE of the above Journal entries should be noted carefully. No entries are made in Share Capital Account until the directors go to allotment, since an application for shares is an *offer* which may be withdrawn at any time prior to allotment.

When more than one class of shares is issued, a separate Application and Allotment Account and Share Capital Account will be opened in respect of each class of share.

The Register of Members, which is a statistical book and is not part of the double entry system, is written up from the Application and Allotment Sheets and the Cash Book; and finally, the share certificates are issued to the shareholders in exchange for the allotment letters, etc. Under Section 67 of the Act, certificates must be complete and ready for issue within two months from the date of allotment, unless the conditions of issue provide otherwise.

Calls on Shares.

When the dates of payment for further instalments are fixed at short intervals (say one or two months from the date of allotment) it is a common practice for the allotment letter to contain instructions as to the payment of the instalments to the company's bankers as and when they become due, together with receipt forms, etc. In such cases, the prospectus usually provides that the issue of the share certificates shall, for the sake of convenience, be deferred until the instalments are fully paid.

If, however, the dates of payment of further instalments are to be determined by the directors, the latter must formally resolve, at a duly-convened board meeting, to call up the amount required, and a "Call Letter" setting out particulars of the amount due, and the date on which payment must be made to the company's bankers, is sent to each shareholder. When Table A is adopted, at least fourteen days' notice of calls must be given to members, a call must not be made less than one month from the date of the last call, and must not exceed (exclusive of premium) one-fourth of the nominal value of the shares.

Call Sheets are prepared in a similar manner to the Application and Allotment Sheets, and details of each individual payment are entered against the shareholder's name in the Register of Members. A journal entry is made debiting First Call Account (or Second Call Account, as the case may be), and crediting Share Capital Account in the general ledger with the total

amount due. As the amounts are paid by the shareholders, entries are made on the debit side of the Cash Book, from which postings are made in the Register of Members, while the daily or other periodical total is credited to the Call Account, the latter account being closed when all the amounts due have been paid. Separate Call Accounts are opened in respect of each class of share issued.

As in the case of the Application and Allotment Account (see page 286) the Call Accounts can be regarded as a "Sundry Shareholders Account."

After payment of the call, the share certificate, accompanied by the bankers' receipt, is returned by the shareholder to the company, so that the payment of the call may be indorsed on the certificate.

Calls Paid in Advance.

It will frequently be found that some shareholders prefer to pay a portion or the whole of the amount not called up on their shares; for example, £1 shares may be issued payable as to 2s. 6d. on application, 2s. 6d. on allotment, and 5s. one month after allotment, the balance of 10s. per share to be called up as and when the directors think fit. In order to avoid the possibility of a call being made at a time inconvenient to himself, a shareholder may wish to pay up at once the full amount of the shares he holds; such payments in advance are in the nature of loans, and, if the company's Articles so provide, interest may be paid by the company on such sums as are not yet due, until the amount is actually called up. If there are no profits this interest must be paid out of capital. (*Lock* v. *Queensland Investment and Land Mortgage Co.*) Table A provides that, unless the company otherwise resolves at a general meeting, the interest must not exceed 6% per annum, and that the member is only entitled to dividends on the *called-up* portion of his shares, and not on the portion bearing interest.

The amount paid up in excess of that due is known as "Calls Paid in Advance," and is recorded in the books of account by making a debit entry for such items in the Cash Book, and crediting the amount to a special Calls Paid in Advance Account in the general ledger. The balance on this special account is shown separately in the Balance Sheet and *not* merged in the share capital, as calls in advance are repayable before called-up capital on liquidation. The amounts so paid are credited in the cash section of the Shareholder's Account in the Register of Members. When the call actually becomes due, a transfer entry is made debiting the Calls Paid in Advance Account, and crediting the appropriate Call Account.

The amount of interest paid by a company on calls in advance is debited to a special Interest on Calls in Advance Account, the balance of which is transferred to the debit of Profit and Loss Account. Such interest is subject to the deduction of Income Tax by the company at the standard rate in force at the date of payment.

Calls in Arrear.

It is generally found that the Articles of a company provide that if a call, or any sum payable at a fixed time by the terms of issue of shares, is not paid when due, interest at a specified rate is chargeable from the due date to the date of payment. The amount of any calls in arrear is shown in the books as a debit balance on Calls Account, and this balance should be disclosed as a deduction from the respective class of issued share capital in the Balance Sheet, the net amount received being extended.

When calls are in arrear on any particular class of share capital, the issued share capital should be described as "called-up" and not "paid-up" in the Balance Sheet.

Table A provides for interest on calls in arrear at the rate of 5% per annum.

The amount of interest (less Income Tax) received by a company on calls in arrear may be credited to Profit and Loss Account by transfer from a special Interest on Calls in Arrear Account. When such interest has accrued at the date of the Balance Sheet, but has not been received by the company, it is considered advisable, from the viewpoint of prudence, to credit the amount accrued to a Reserve Account and to defer the transfer to Profit and Loss Account until the interest is actually received.

Allotment of Shares credited as Fully Paid.

It is settled law that shares may be paid for either "in cash or in kind"; but where shares are allotted for a consideration other than cash, e.g., for the transfer to the company of the assets of a business, a contract constituting the title of the allottee to the shares (such contract setting forth full particulars of the property, etc., transferred) must be filed with the Registrar of Companies (Section 42). If the contract is not reduced to writing, the prescribed particulars, stamped with the same duty as would have been necessary if the contract had been in writing, must be similarly filed.

Shares issued in this way in exchange for assets may be credited as "fully paid" or as "partly paid"; when issued as partly paid the balance must be paid in cash as and when calls

are made by the directors. Debentures may be issued in exchange for assets in a similar manner. The entries required are indicated by the following *pro formâ* journal entries :—

JOURNAL

		Dr.	Cr.
19..		£	£
Jan. 1	Goodwill . . . . . . *Dr.*	12,000	
	Land and Buildings . . . . . „	15,000	
	Plant and Machinery . . . . „	5,000	
	Stock-in-trade . . . . . . „	7,500	
	Sundry Debtors . . . . . . „	11,500	
	Cash . . . . „	1,000	
	To Sundry Creditors		8,000
	„ Brown & Jones		44,000
	Being assets acquired, liabilities taken over, and consideration for the purchase of the business of Brown & Jones, in accordance with the contract dated ....19..		
Jan. 10	Brown & Jones . . . . . *Dr.*	44,000	
	To Share Capital Account . . .		35,000
	„ Cash		9,000
	Being nominal value of shares credited as fully paid, allotted to		
	Alfred Brown . . £20,000		
	Arthur Jones . . 15,000		
	and Cash paid in settlement of purchase price of the business as per contract dated.............19.., and resolution of of the directors dated.................19..		

Issue of Shares at a Discount.

By Section 47, a company is allowed to issue at a discount *shares of a class already issued*, provided that :—

(*a*) The issue is authorised by a resolution passed at a general meeting of the company and sanctioned by the Court ;

(*b*) The resolution specifies the maximum rate of discount at which the shares are to be issued ;

(*c*) At the date of issue at least one year has elapsed since the date on which the company was entitled to commence business ; and

(*d*) The shares are issued within one month after the date on which the issue was sanctioned by the Court or within any extended time allowed by the Court.

Particulars of any discounts allowed on such shares, and not yet written off, must be disclosed in every annual return, and in every prospectus relating to the issue of the shares, and in every Balance Sheet issued subsequently to the issue of the shares.

The power to issue shares at a discount is useful where a company requires further capital at a time when its shares are quoted on the Stock Exchange below their nominal value, since the public would normally not be willing to pay the full nominal value for new shares under such circumstances but might be quite willing to subscribe at a price below the nominal value of the shares.

EXAMPLE.

A limited company, having complied with the necessary legal formalities, makes an issue of 100,000 Ordinary Shares of £1 each, at 2s. 6d. discount, 5s. payable on application and 12s. 6d. on allotment. The entire issue having been applied for and allotted, show the Journal entries necessary to record these transactions.

JOURNAL.

	Dr. £	*Cr.* £
Cash . . . . *Dr.*	25,000	
To Application and Allotment Account		25,000
Being amounts paid by sundry applicants on applications (5s. per share) for 100,000 *Ordinary Shares.*		
Application and Allotment Account *Dr.*	87,500	
Discount on Shares Account . . ,,	12,500	
To Ordinary Share Capital Account .		100,000
Being issue of 100,000 *Ordinary Shares of* £1 *each at a discount of* 2*s.* 6*d., as per resolution dated . . . and sanction of Court dated . . . (Vide Minute Book, Resolution No. . .).*		
Cash . . . . *Dr.*	62,500	
To Application and Allotment Account		62,500
Being receipt of allotment moneys.		

NOTE.—The discount must be brought into the books *when the shares are allotted,* since the statutory necessity to disclose the discount in the Balance Sheet arises when the shares are issued.

The Underwriting of Shares

Except as provided above, shares must not be issued at a discount; the company must receive the full nominal amount or "face value" of its shares, but where the Articles so authorise, and the amount or rate per cent. is stated in the prospectus, a company may pay "underwriting commission" (Section 43).

Underwriting is the application of the principle of insurance to company formation. Persons called "underwriters" agree that if the whole or a certain proportion of the shares of the company is not applied for by the public, they will themselves apply or find responsible persons to apply for the balance or a certain proportion of the balance of the shares. The underwriter addresses a letter to the promoter or the company agreeing

to underwrite a specified amount of the issue upon the condition that he shall be liable to take up only his proportion of the shares not taken up by the public, and that in any event he shall receive a specified commission. Although the letter is couched in terms of an agreement, it is in fact only an offer by the underwriter; it requires to be accepted by the promoter or the company, and such acceptance must be communicated to the underwriter.

If the letter containing the underwriter's offer is addressed to the promoter, or to someone engaged in the formation of the company, it usually authorises the offeree to apply for the shares on behalf of the underwriter if the latter makes default. Such an authority is irrevocable after acceptance by the offeree, and performance of any conditions stipulated in the underwriting letter.

It is customary for the underwriter to attach to the underwriting letter a cheque for the amount of the application money payable on the shares underwritten. After allotment, the underwriter's account is adjusted by a further cheque from him or a return of the overpayment. The commission payable under the agreement is the subject of a separate settlement and may be paid in cash or by the issue of fully-paid shares. Financial agents who place the *underwriting* with their clients are usually paid an OVERRIDING COMMISSION. The underwriters may enter into sub-underwriting contracts with other underwriters under which they agree to take up a proportionate share of those shares for which the public does not subscribe. Such contracts are made between the underwriters only, the company not being a party thereto.

The underwriting agreement sometimes provides that applications which are "marked" with the underwriter's stamp or signature shall be applied in reduction of his liability if the issue is not fully subscribed.

A person is said to underwrite "firm" when he agrees to retain as an investment or for resale part of the shares underwritten.

Similarly, an authorised rate of commission may be paid for "placing" shares, or, in the words of the Act, for "procuring subscriptions for shares." This must be distinguished from underwriting—in effect, it merely involves acting as an agent for the sale of shares and obtaining buyers for them.

The amount of the commissions paid must be clearly shown as a separate item in the Balance Sheet until it is written off out of subsequent revenue.

The commission payable must not in any case exceed 10 per cent. of the price at which the shares are issued, and the number of shares underwritten "firm" must be disclosed in the prospectus or statement in lieu thereof.

In addition to underwriting commission, a company may legally pay a *reasonable* [1] "brokerage" to stockbrokers and others who introduce applicants for shares or debentures. In such cases the application forms are marked by the broker with his office stamp.

EXAMPLE.

The Stone Co., Ltd., makes a public issue of 50,000 shares of £1 each at par on 1st January, payable 5s. per share on application, 5s. on allotment, and the balance as and when required. *A* underwrites 20,000 shares, *B* 20,000 shares, and *C* 10,000 shares for a commission of $2\frac{1}{2}\%$. *A* himself takes 5,000 out of the 20,000 shares which he underwrites. The company went to allotment on 10th January on a public subscription of 27,000 shares. Show the records of the above transactions.

Total shares issued		50,000
Public subscription	27,000	
* Taken by *A*	5,000	32,000
* Underwriters' net liability		18,000

* NOTE.—In some cases, the underwriters' combined liability is determined by the difference between the total issue and public subscription; subscriptions taken by any underwriter for himself, i.e., taken "firm," being deducted from each individual's proportion of the combined liability. The method to be adopted depends upon the precise wording of the underwriting letter.

	Shares Underwritten.	Shares taken Firm.	Liability.	Proportion.	Net Liability.
A	20,000	5,000	15,000	$\frac{15}{45}$ of 18,000	6,000
B	20,000	..	20,000	$\frac{20}{45}$ of 18,000	8,000
C	10,000	..	10,000	$\frac{10}{45}$ of 18,000	4,000
	50,000	5,000	45,000		18,000

UNDERWRITERS' LIABILITY.

	Total shares allotted.	Total Amount payable at 10s.	Amount of Deposit.	Balance payable.	Amount returnable.	Date of Payment.	C.B. Fo.
		£	£	£	£	19..	
A .	11,000	5,500	5,000	500	..	Jan. 11	1
B .	8,000	4,000	5,000	..	1,000	" 10	1
C .	4,000	2,000	2,500	..	500	" 10	1
	23,000	£11,500	£12,500	£500	£1,500		

[1] It has been held (*Metropolitan Coal Association* v. *Scrimgeour*) that $2\frac{1}{2}$ per cent. is reasonable brokerage.

CASH BOOK.

Dr.				*Cr.*			
19..			£	19..			£
Jan. 1	To Sundry Underwriters :— *A*, deposit on 20,000 shares . .		5,000	Jan. 10	By Sundry Underwriters, amount refunded :— *B*, . £1,000 *C*, . . 500		1,500
	B, deposit on 20,000 shares . .		5,000	„ 10	„ Underwriting Commission :— *A*, . . £500 *B*, . . 500 *C*, . . 250		1,250
	C, deposit on 10,000 shares . .		2,500	„ 11	„ Balance . .	*c/d.*	23,750
„ 1	„ Application and Allotment A/c.— Deposits on applitions for 27,000 shares . .		6,750				
„ 11	„ Sundry Underwriters :— Further amount paid		500				
„ 11	„ Application and Allotment A/c.— Amounts paid on allotment of 27,000 shares .		6,750				
			£26,500				£26,500
Jan. 11	To Balance	*b/d.*	23,750				

JOURNAL.

			Dr. £	*Cr.* £
19.. Jan. 10	Application and Allotment Account . *Dr.* To Share Capital Account . . . *Being amounts payable on application (5s.), and allotment (5s.) per share on 27,000 shares, numbered 1 to 27,000, allotted in response to sundry applications as per resolution of the directors dated............, 19..*		13,500	13,500
Jan. 10	Application and Allotment Account . *Dr.* To Share Capital Account . . . *Being amounts payable on application (5s.) and allotment (5s.) per share on 23,000 shares, numbered 27,001 to 50,000, allotted to sundry underwriters this date, per resolution of the directors dated............, 19..*		11,500	11,500
Jan. 10	Sundry Underwriters . . . *Dr.* To Application and Allotment Account . *Being transfer of amounts paid on shares allotted to underwriters.*		11,500	11,500

The Ledger Accounts will appear as follows :—

Dr SUNDRY UNDERWRITERS. Cr.

		£			£
19..			19..		
Jan. 10	To Application and Allotment A/c. .	11,500	Jan. 1	By Cash . . .	12,500
„ 10	„ Cash . . .	1,500	„ 11	„ „ . . .	500
		£13,000			£13,000

Dr. APPLICATION AND ALLOTMENT ACCOUNT. Cr.

		£			£
19..			19..		
Jan. 10	To Share Capital A/c.	13,500	Jan. 1	By Cash . .	6,750
„ 10	„ „ „ „	11,500	„ 10	„ Sundry Underwriters . .	11,500
			„ 11	„ Cash . . .	6,750
		£25,000			£25,000

Dr. UNDERWRITING COMMISSION ACCOUNT. Cr

		£			
19..					
Jan. 10	To Cash . . .	1,250			

This account is usually written off by periodical allocations of profits from the Profit and Loss Account.

Dr. SHARE CAPITAL ACCOUNT. Cr.

					£
			19..		
			Jan. 10	By Application and Allotment A/c. .	13,500
			„ 10	„ Application and Allotment A/c. .	11,500

Where only a part of an issue is underwritten, the underwriter is only liable for a corresponding part of the shares not taken up by the public. Thus, if an issue of 50,000 shares is made, of which 25,000 are underwritten, and the public apply for only 20,000 shares, the liability of the underwriter will be restricted to 15,000 shares, i.e., 50 per cent. of the shares not taken up by the public. In effect, the company may be looked upon as its own underwriter for that portion of the issue which it has not underwritten.

Premiums on Shares.

The real or "intrinsic" value of shares largely depends upon the success (or otherwise) of a company as evidenced by the amount of dividends paid and the strength of the financial position disclosed in its balance sheets. Thus, a successful company making a further issue of shares is often able to obtain for such shares a higher price than their nominal or face value; in other words they are issued "at a premium."

These premiums, when received, should be debited to cash and credited to a special "Premium on Shares Account," and shown separately, under that heading, in the company's Balance Sheets. Alternatively, they may be credited to a Capital Reserve Account and may be used, in certain cases, to write down the book values of such items as Goodwill, Preliminary Expenses, etc. They must not be credited to Share Capital Account as they do not form part of the capital of the company. Premiums on shares are not trading profits, and it is therefore inadvisable to credit them to the Profit and Loss Account, although, subject to any provision in the Articles, it would not be illegal to do so.

EXAMPLE.

The Newcome Company, Limited, issued, on 1st March, 25,000 Ordinary shares of £1 each at a premium of 5s. per share, payable as to 2s. 6d. on application, 7s. 6d. on allotment (including the premium), and the balance as and when required. The company went to allotment on 10th March. Prepare Journal entries recording the above transactions.

JOURNAL.

		Dr.	Cr
19..		£	£
Mar. 1	Cash . . . . Dr.	3,125	
	To Application and Allotment Account .		3,125
	Being amounts paid by sundry applicants on applications (2s. 6d. per share) for 25,000 Ordinary Shares of £1 each.		
Mar. 10	Application and Allotment Account . Dr.	12,500	
	To Share Capital Account . . .		6,250
	,, Premium on Shares Account . .		6,250
	Being total amount payable on application (2s. 6d. per share) and allotment (7s. 6d., including the premium, 5s. per share) on 25,000 Ordinary Shares of £1 each, numbered 1 to 25,000, allotted this day. (Vide Minute Book, Resolution No. ...)		
Mar. 12	Cash . . . . Dr.	9,375	
	To Application and Allotment Account .		9,375
	Being receipt of amounts due on allotment.		

Premiums on shares may be payable either with the application money or with the allotment money or with one of the call moneys, according to the terms of issue. This treatment should be compared with that obtaining in the case of an issue of shares at a discount (see page 290).

Preliminary Expenses.

The whole of the expenses consequent upon the formation and incorporation of the company are charged to a Preliminary Expenses Account and treated, temporarily, as a fictitious asset. These preliminary expenses include such items as—

(1) Legal, accounting and valuation charges, capital duty and other stamps and fees on various documents relating either to incorporation or to the conveyance to the company of property acquired.

(2) Cost of memorandum, articles, prospectus and advertisements.

(3) Cost of share certificates, the statutory registers, books of account and the company's seal.

This account should be written off out of profits as soon as possible, say during the first four or five years of the existence of the company.

The Balance Sheet of the company must show, under separate headings, the following items, so far as they are not written off :—

(*a*) The preliminary expenses; and

(*b*) The expenses incurred in connection with any issue of share capital or debentures (Section 124, Companies Act, 1929).

From the strict wording of Section 124, it would appear that the cost of advertising the prospectus, preparing the share certificates, stamp duty on return of allotments, etc., are expenses incurred in connection with an issue of capital and should therefore be kept distinct from preliminary expenses such as legal fees and stamp duties on the purchase of assets, valuers' and auditors' fees in connection with the prospectus, cost of memorandum, etc. It is sometimes difficult, however, to see exactly where the line should be drawn.

A PRACTICAL EXAMPLE OF COMPANY FORMATION

The following example illustrates the entries required in the financial books of a newly-formed company, and the entries in the Application and Allotment Book and Register of Members.

EXAMPLE.

The Stoneware Company, Limited, with an authorised capital of 20,000 Ordinary Shares of £1 each, is formed to acquire the business of Smith & Brown on 1st January, 19.. The assets acquired comprise—

Goodwill . . .	£5,000	Premises . .	£4,000
Plant, Machinery . .	1,500	Stock . .	3,500
Debtors . . .	2,500	Cash . . .	1,500

and the liabilities taken over amount to £2,000, owing to sundry creditors.

The vendors, Arthur Smith and William Brown (who are equal partners), agree to accept £12,000 in fully paid shares and the balance in cash (to be paid on 12th February 19..). They also take 1,000 shares each, for which they pay cash in the usual way.

Preliminary expenses amounting to £900 were paid by the company on 12th February, 19..

Shares are applied for and allotted as follows :—

	Applied for	*Allotted.*
Arthur Smith	1,000	1,000
William Brown	1,000	1,000
Albert Jones	1,500	1,500
William Black	1,500	1,500
Edward Lord	3,000	2,000
Arthur Richards	500	500
Alfred Miller	500	500

The shares were payable, 5s. on application, 5s. on allotment (9th January, 19..), and the remaining 10s. per share on 10th February, 19..

JOURNAL.

			Dr. £	Cr. £
19..				
Jan. 9	Application and Allotment Account . *Dr.*		4,000	
	To Share Capital Account . . .			4,000
	Being amounts payable on application (5s.) and allotment (5s.) per share on 8,000 Ordinary Shares, numbered 1 to 8,000, allotted to sundry persons this date. (*Vide Minute Book, Resolution No...*)			
Jan. 9	Sundries . . . . *Dr.*			
	To Sundries :—			
	Goodwill		5,000	
	Premises		4,000	
	Plant and Machinery		1,500	
	Stock in trade		3,500	
	Debtors		2,500	
	Cash		1,500	
	To Creditors			2,000
	,, Vendors			16,000
	Being assets acquired, liabilities taken over, and purchase price of the business of Messrs Smith & Brown, in accordance with contract dated ...., 19.., and resolution of the directors, dated ...., 19..			
Jan. 9	Vendors . . . . *Dr.*		12,000	
	To Share Capital Account . . .			12,000
	Being allotment of 12,000 Ordinary Shares, Nos. 8,001 to 20,000, in part settlement of purchase price per resolution of the directors, dated.........., 19..			
Feb. 10	Call Account . . . . . . *Dr.*		4,000	
	To Share Capital Account . . .			4,000
	Being amount of call, 10s. per share, on 8,000 Ordinary Shares due this day in accordance with the terms of the prospectus, dated..........., 19..			

APPLICATION AND ALLOTMENT BOOK (OR SHEET) OF THE STONEWARE CO., LTD.

Application No.	Allotment No.	Date of Application.	Surname.	Christian Name.	Address.	Occupation or Description.	Shares applied for.	Amount paid on Application at 5s. per Share.	Allotment: Shares allotted.	Allotment: Total Amount payable at 10s. per Share.	Allotment: Balance payable on Allotment.	Date paid.	Cash Book Folio.	Amount returnable.	Call due 10th Feb. 19..: Amount payable.	Call due 10th Feb. 19..: Date paid.	Call due 10th Feb. 19..: Cash Book Folio.	Distinctive Numbers of Shares: From	Distinctive Numbers of Shares: To	Reg. of Mem. Fo.	Share Cert. No.	Remarks.
		19..						£		£	£	19..			£	19..						
1	1	Jan. 1	Smith	Arthur	Fern Villa, Croydon	Manufacturer	1,000	250	1,000	500	250	Jan. 11	1		500	Feb. 12	2	1	1,000	1	1	
2	2	,, 1	Brown	William	Elm House, Richmond	do.	1,000	250	1,000	500	250	,, ,,	1		500	,, ,,	2	1,001	2,000	2	2	
3	3	,, 1	Jones	Albert	31 Maple Road, Acton	Secretary	1,500	375	1,500	750	375	,, ,,	1		750	,, ,,	2	2,001	3,500	3	3	
4	4	,, 2	Black	William	22 Dale Road, Croydon	Accountant	1,500	375	1,500	750	375	,, ,,	1		750	,, ,,	2	3,501	5,000	4	4	
5	5	,, 2	Lord	Edward	14 Hart Street, Bloomsbury	Solicitor	3,000	750	2,000	1,000	250	,, ,,	1		1,000	,, ,,	2	5,001	7,000	5	5	
6	6	,, 2	Richards	Arthur	24 Mead Avenue, Croydon	Bank Manager	500	125	500	250	125	,, ,,	1		250	,, ,,	2	7,001	7,500	6	6	
7	7	,, 2	Miller	Alfred	36 Field Street, Enfield	Traveller	500	125	500	250	125	,, ,,	1		250	,, ,,	2	7,501	8,000	7	7	
							9,000	£2,250	8,000	£4,000	£1,750				£4,000							

8,000 Shares allotted, 9th January 19..
WM. BROWN,
Chairman.

NOTE.—It is useful to have an extra column for calls paid in advance.

Call Sheets are prepared in similar manner to the above, the headings for the various columns being Call Letter No., Shareholder's Name and Address, Share Ledger Folio, Number of Shares, Amount, Date of Payment, Cash Book Folio, and Remarks.

Dr. [EXTRACTS FROM] CASH BOOK. *Cr.*

19..		£	£	19..		£
Jan. 1	To Vendors . . .		1,500	Feb.12	By Vendors . . .	4,000
" "	" Application and Allotment Account—			" "	" Preliminary Expenses	900
" "	A. Smith, No. 1 .	250				
" "	W. Brown, " 2 .	250				
" "	A. Jones, " 3 .	375				
" 2	W. Black, " 4 .	375				
" "	E. Lord, " 5 .	750				
" "	A. Richards, " 6 .	125				
" "	A. Miller, " 7 .	125				
		——	2,250			
Jan. 11	" Application and Allotment Account—					
" "	A. Smith, No. 1 .	250				
" "	W. Brown, " 2 .	250				
" "	A. Jones, " 3 .	375				
" "	W. Black, " 4 .	375				
" "	E. Lord, " 5 .	250				
" "	A. Richards, " 6 .	125				
" "	A. Miller, " 7 .	125				
		——	1,750			
Feb. 12	" Call Account—					
" "	A. Smith, No. 1 .	500				
" "	W. Brown, " 2 .	500				
" "	A. Jones, " 3 .	750				
" "	W. Black, " 4 .	750				
" "	E. Lord, " 5 .	1,000				
" "	A. Richards, " 6 .	250				
" "	A. Miller, " 7 .	250				
		——	4,000			

Dr. ORDINARY SHARE CAPITAL ACCOUNT. *Cr.*

19..			£	19..			£
Feb. 10	To Balance .	*c/d.*	20,000	Jan. 9	By Appln. and Allotment Account .		4,000
				" 9	" Vendors .		12,000
				Feb. 10	" Call Account		4,000
			£20,000				£20,000
				Feb. 10	By Balance .	*b/d.*	20,000

Dr. APPLICATION AND ALLOTMENT ACCOUNT. *Cr.*

19..		£	19..		£
Jan. 9	To Ordinary Share Capital Account .	4,000	Jan. 2	By Cash . .	2,250
			" 11	" " . .	1,750
		£4,000			£4,000

Dr. CALL ACCOUNT. *Cr.*

19..			£	19..			£
Feb. 10	To Ordinary Share Capital Account .		4,000	Feb. 12	By Cash . .		4,000

Dr. VENDORS' ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 9	To Ordinary Share Capital Account .		12,000	Jan. 9	By Sundry Net Assets . .		16,000
Feb. 12	" Cash . .		4,000				
			£16,000				£16,000

Dr. PRELIMINARY EXPENSES ACCOUNT. *Cr.*

19..			£				
Feb. 12	To Cash . .		900				

Dr. GOODWILL ACCOUNT. *Cr.*

19..			£				
Jan. 9	To Vendors		5,000				

Dr. PREMISES ACCOUNT. *Cr.*

19			£				
Jan. 9	To Vendors .		4,000				

Dr. PLANT AND MACHINERY ACCOUNT. *Cr.*

19..			£				
Jan. 9	To Vendors .		1,500				

Dr. STOCK-IN-TRADE ACCOUNT. *Cr.*

19..			£				
Jan. 9	To Vendors .		3,500				

Dr. SUNDRY DEBTORS. **Cr.**

19.. Jan. 9	To Vendors .		£ 2,500				

Dr. SUNDRY CREDITORS. **Cr.**

				19.. Jan. 9	By Vendors .		£ 2,000

Note.—The last two accounts are included for the sake of completeness, but in practice the Sundry Debtors and Sundry Creditors would appear in the books as a series of opening balances upon personal accounts in the sales ledger and purchases ledger respectively,

THE STONEWARE CO., LTD.

Balance Sheet as at 12th February, 19..

Liabilities.	£	*Assets.*	£
Authorised Capital:—		Goodwill at cost . . .	5,000
20,000 Ordinary Shares of £1		Premises at cost . . .	4,000
each	20,000	Plant and Machinery at cost .	1,500
Issued Capital:—		Stock-in-trade . . .	3,500
20,000 Ordinary Shares of £1		Sundry Debtors . . .	2,500
each, fully paid . .	20,000	Cash	4,600
Sundry Creditors . . .	2,000	Preliminary Expenses . .	900
	£22,000		£22,000

REGISTER OF MEMBERS AND SHARE LEDGER.

NAME	*Arthur Smith,*	DATE OF ENTRY AS A MEMBER:	*9th January, 19* .
ADDRESS:	*Fern Villa, Croydon.*	DATE OF CEASING TO BE A MEMBER:	
DESCRIPTION:	*Manufacturer.*		

Dr. CASH ACCOUNT. *Cr.*

Date.	Particulars.	No.	Amount.	Date.	Particulars.	C.B. Fo.	Amount.
19..			£ s. d.	19..			£ s. d.
Jan. 9	To Appn. and Allot.	1	500 0 0	Jan. 1	By Cash . .	1	250 0 0
Feb. 10	,, First Call .	1	500 0 0	,, 11	,, ,, . .	1	250 0 0
				Feb. 12	,, ,, . .	2	500 0 0
			£1,000 0 0				£1,000 0 0

SHARES ACQUIRED.						SHARES DISPOSED OF.					
Date.	Allot. No. or Trsfr. No.	No. of Shares.	Distinctive Nos. From	Distinctive Nos. To	Nominal Value.	Date.	Transfer No.	No. of Shares.	Distinctive Nos. From	Distinctive Nos. To	Nominal Value.
19..					£ s. d.						£ s. d.
Jan. 9	1	1,000	1	1,000	1,000 0 0						
9	8	6,000	8,001	14,000	6,000 0 0						
	credited as fully paid on issue.										

The remaining shareholders' accounts will appear in similar form to the above, and their combined balances will equal the balance of the Share Capital Account in the general ledger.

The Statutory Report.

Within a period of not less than one month nor more than three months from the date at which a newly-formed public company is entitled to commence business, it must hold a general meeting —termed the "statutory meeting"—for the discussion of any matter arising out of (1) the formation of the company, and (2) the "statutory report."

THE STATUTORY REPORT is the report which, in accordance with Section 113 of the Companies Act, 1929, must be circulated among the members of every public company limited by shares, at least seven days before the date of the "statutory meeting."

The report must state, *inter alia*, the number of shares allotted, distinguishing those fully or partly paid-up otherwise than in cash, and the consideration given; the total amount of cash received in respect of its shares distinguished as aforesaid; an abstract of the company's receipts and the payments thereout, exhibiting under distinctive headings the company's receipts from shares and debentures and other sources, and the payments made thereout, with an account of the balance in hand, and an account or estimate of the preliminary expenses; the names, addresses, and descriptions of directors, auditors (if any), managers (if any), and secretary; and particulars of any contract the modification of which the meeting will be asked to approve, together with particulars of the modification or proposed modification.

The statutory report as a whole must be certified by at least two directors, or, where there are less than two directors, by the sole director and manager, and as regards the total number of shares allotted, the total cash received in respect of such shares, and the receipts and payments on capital account, by the auditors (if any), as being a correct report. A copy, duly certified, must be filed with the Registrar immediately copies are sent to members of the company. A private company need not hold a statutory meeting nor prepare or file a statutory report.

An example of the Statutory Report is given on page 305.

Number of Certificate } *7,241,506*

Form No. 46.

"THE COMPANIES ACT, 1929."

STAMP 5/-

Report

(Pursuant to Section 113 of The Companies Act, 1929)

OF

The Stoneware Company LIMITED.

(*a*) The Total Number of Shares allotted is *20,000*, of which *12,000* are allotted *as fully paid up*, in consideration of *Sundry Assets and Liabilities transferred to the Company by virtue of the agreement, dated 21st January 19.., entered into with the vendors*, and upon each of the remaining Shares the sum of *One Pound* has been paid in Cash.

(*b*) The Total Amount of Cash received by the Company in respect of the Shares issued wholly for Cash is *£8,000*, and on the Shares issued partly for Cash is *nil*.

(*c*) The Receipts and Payments of the Company to the *First* day of *March*, 19.., are as follows :—

Particulars of Receipts.	£	s.	d.	Particulars of Payments.	£	s.	d.
Cash taken over from Vendors .	*1,500*	*0*	*0*	*Part Payment of Purchase of Business*	*4,000*	*0*	*0*
Sundry Shareholders . .	*8,000*	*0*	*0*	*Preliminary Expenses* .	*900*	*0*	*0*
Trading Receipts . . .	*2,500*	*0*	*0*	*Trading Payments* . . .	*2,000*	*0*	*0*
				Balance, Cash at Bank	*5,100*	*0*	*0*
	£12,000	*0*	*0*		*£12,000*	*0*	*0*

Presented for filing by Albert Jones, Chartered Secretary,
21 Finsbury Pavement,
E.C.2.

The following is an Account (*or* Estimate) of the Preliminary Expenses of the Company :—

	£	s.	d.
Amount payable to Vendors in accordance with terms of agreement dated 21st January 19..	*£900*	*0*	*0*

(*d*) Names, Addresses, and Descriptions of the Directors, Auditors (if any), Managers (if any), and Secretary of the Company :—

DIRECTORS.

Surname.	Christian Name.	Address	Description.
Smith	*Arthur*	*Fern Villa, Croydon*	*Manufacturer*
Brown	*William*	*Elm House, Richmond*	*Do*

AUDITORS.

Names.	Address.	Description.
Griffiths & Bandon	*51 Coleman Street E.C.2.*	*Chartered Accountants*

MANAGERS.

Surname.	Christian Name.	Address.	Description.

SECRETARY.

Surname.	Christian Name.	Address.	Description.
Jones	*Albert*	*21 Finsbury Pavement, E.C.2.*	*Chartered Secretary*

(*e*) Particulars of any Contract the modification of which is to be submitted to the Meeting for its approval, together with the particulars of the modification or proposed modification :—

Nil.

We hereby Certify this Report.

A. Smith, } Two
Wm. Brown, } *Directors*

We hereby Certify that so much of this Report as relates to the Shares allotted by the Company and to the Cash received in respect of such Shares and to the Receipts and Payments of the Company on Capital Account is correct.

Griffiths & Bandon, } *Auditors.*
Chartered Accountants. }

Dated the *5th* day of *March*, 19..

Transfer of Shares.

Transfers of shares are recorded in the Register of Transfers (see page 281), from which the entries are posted to the Register of Members. All transfers must be sanctioned by resolution of the Board of Directors. It is customary for companies to demand a small charge (usually 2s. 6d.) for registration of a transfer. These transfer fees are debited in the cash book and credited through a Transfer Fees Account to the Profit and Loss Account. Apart from these entries, the transfer of shares will not affect the accounting entries in the books of the company.

After a call has been made, the customary practice of limited companies is to accept transfers of shares only if the bankers' receipt for payment of the call money is produced with the relative transfer and share certificate. Occasionally, however, shareholders are unable to pay the call, and accordingly sell all or part of their shares to some one who is willing to undertake the liability. The following problem illustrates this procedure :—

EXAMPLE.

On 1st February, 19.., a company offered for subscription 100,000 Ordinary Shares of £1 each, of which 2s. 6d. was payable on application, 2s. 6d. on allotment, 2s. 6d. on 1st March, 2s. 6d. on 1st April, 2s. 6d. on 1st May, 2s. 6d. on 1st June, and the remainder in calls of 2s. 6d. as and when required on one month's notice.

Among the allottees (No. 21) was James Summerville, of 80 High Street, Smethwick, Ironfounder, who, on 4th February, 19.., applied for 1,000 shares, which were allotted to him on 15th February, and he paid the amount due on allotment on 18th February. The amounts due on the first, second, and third calls he paid on the due dates. On 10th May he transferred 400 of these shares to Peter Oak, Metal Merchant, of 110 Market Street, Swansea. On 3rd June, James Summerville paid the fourth call on the shares then held by him. Supply distinctive numbers to the shares, and record the transactions as regards James Summerville and Peter Oak in a Share Ledger ruled in such a way as you think most suitable and convenient

REGISTER OF MEMBERS AND SHARE LEDGER.

NAME: *James Summerville,*
ADDRESS: *80 High Street, Smethwick.*
DESCRIPTION: *Ironfounder.*
DATE OF ENTRY AS A MEMBER: *15th February,* 19..
DATE OF CEASING TO BE A MEMBER:

Dr. CASH ACCOUNT. Cr.

Date.	Particulars.		No.	Amount.	Date.	Particulars.	C.B. Fo.	Amount.
19..		per share.		£	19..			£
Feb. 15	To Appln. and Allot.	5/-		250	Feb. 4	By Cash		125
Mar. 1	,, First Call	2/6		125	,, 18	,, ,,		125
Apl. 1	,, Second Call	2/6		125	Mar. 1	,, ,,		125
May 1	,, Third Call	2/6		125	Apl. 1	,, ,,		125
June 1	,, Fourth Call	2/6		75	May 1	,, ,,		125
					June 3	,, ,,		75

SHARES ACQUIRED.

Date.	Allotment or Transfer No.	No. of Shares.	Distinctive Nos. From	To	Nominal Amount.
19..					£
Feb. 15	21	1,000	5,001	6,000	1,000
					£1,000
May 10	*b/d.*	600	5,401	6,000	600

SHARES DISPOSED OF.

Date.	Transfer No.	No. of Shares.	Distinctive Nos. From	To	Nominal Amount.
19..					£
May 10	50	400	5,001	5,400	400
	Bal. *c/d.*	600	5,401	6,000	600
					£1,000

NAME: *Peter Oak,*
ADDRESS: *110 Market Street, Swansea.*
DESCRIPTION: *Metal Merchant.*
DATE OF ENTRY AS A MEMBER: *10th May,* 19..
DATE OF CEASING TO BE A MEMBER

Dr. CASH ACCOUNT. Cr.

Date.	Particulars.	No.	Amount.	Date.	Particulars.	C.B. Fo.	Amount.
19..			£				
May 10	Shares, 12/6 paid up on transfer						
June 1	To Fourth Call, 2/6		50				

SHARES ACQUIRED.

Date.	Allotment or Transfer No.	No. of Shares	Distinctive Nos. From	To	Nominal Amount.
19..					£
May 10	50	400	5,001	5,400	400

SHARES DISPOSED OF.

Date.	Transfer No.	No. of Shares.	Distinctive Nos. From	To	Nominal Amount.

A considerable proportion of the transfers which are effected is, however, in respect of shares which are already fully paid. Apart from this fact, the entries in the Register of Members are on similar lines to those in the above example.

Transmission of Shares.

Upon the death of a shareholder, the shares held by him are not transferred to his executor or administrator, but remain in the name of the deceased member until they are sold or until they are transferred to a beneficiary. Subject to the provisions of the company's Articles, however, the deceased shareholder's executors or administrators can, if they wish, have the shares transferred into their own names.

The usual procedure is for the executor or administrator to forward to the company a copy of the probate or letters of administration for registration. Particulars are entered in a Register of Probates, and a memorandum of the death is made on the deceased shareholder's account in the Register of Members, together with the names and addresses of the executors or administrators.

The Act provides that production to the company of any document which is legal evidence of probate, or letters of administration, must be accepted by the company, notwithstanding anything in its Articles.

Forfeiture and Reissue of Shares.

Where the amount due upon shares is payable by instalments, it occasionally happens that a shareholder fails to pay one of the instalments. The articles of association of most companies authorise the directors, after certain formalities have been observed, to "forfeit" such shares. The procedure as laid down by Table A, and its effects, are as follows :--

(a) Directors may, at any time after failure to pay a call or instalment, serve the defaulting member with a notice requiring payment of the amount due, with any accrued interest.
(b) The notice must give at least fourteen days for payment, and must state that the shares will be forfeited in the event of non-payment.
(c) If default is made, the directors may resolve to forfeit the shares.
(d) Forfeited shares may be sold or otherwise disposed of, but until this happens the forfeiture may be cancelled.
(e) The defaulter ceases to be a member of the company, but until the nominal amount of the shares is received, he is liable to the company for all sums due from him at the date of forfeiture.
(f) A statutory declaration of a director stating that certain shares have been forfeited, and a receipt for the amount paid, form a good title to the shares.
(g) Calls, instalments and premiums on the shares are included in the above provisions.

When shares are forfeited the entries required in the company's financial books are :—

(i) Debit the Share Capital Account and credit Forfeited Shares Account with the whole amount previously credited to the former account in respect of the shares forfeited (i.e., the amount *called-up* on the shares).

(ii) Debit the Forfeited Shares Account and credit the Call Account or Accounts with the instalments owing but unpaid by the shareholder at the time of forfeiture.

Unless or until the shares are reissued, the balance on the Forfeited Shares Account (representing the amount already received from the defaulting member) will be shown as a separate item on the liabilities side of the Balance Sheet.

EXAMPLE.

The X. Y. Z. Co., Ltd., has a nominal capital of £20,000, divided into 20,000 Ordinary Shares of £1 each. The whole of the capital has been issued at par on the following terms :—

Payable on Application	2s. 6d. per share.
Payable on Allotment	2s. 6d. per share.
First Call	10s. 0d. per share.
Second Call	5s. 0d. per share

The calls have been made and paid in full by the members with the exception of A. Jackson, who has failed to pay the first and second calls on the 100 shares allotted to him. On 1st December the directors resolve to forfeit the shares.

Show the journal entries recording the forfeiture, the Call Accounts, and the Share Capital Account, and show how the above items will appear in a Balance Sheet prepared immediately after the forfeiture.

JOURNAL.

19..		£	£
Dec. 1	Share Capital Account . . . . . *Dr.*	100	
	To Forfeited Shares Account		100
	Being forfeiture of 100 shares allotted to A. Jackson, for non-payment of the first and second calls of 10s. and 5s. per share respectively, as per Resolution of this date.		
„ „	Forfeited Shares Account . . . . *Dr.*	75	
	To First Call Account		50
	„ Second Call Account		25
	Being transfer of calls unpaid on forfeiture of the above shares.		

Dr SHARE CAPITAL ACCOUNT. Cr

19..			£	19..			£
Dec. 1	To Forfeited Shares Account . .		100		By Application and Allotment Account .		5,000
"	" Balance . . .	c/d.	19,900		" First Call Account .		10,000
					" Second Call Account		5,000
			£20,000				£20,000
				19.. Dec. 1	By Balance . . .	b/d.	19,900

Dr. FIRST CALL ACCOUNT. Cr.

19..			£	19..			£
	To Share Capital Account		10,000	Dec. 1	By Cash . . .		9,950
					" Forfeited Shares Account . .		50
			£10,000				£10,000

Dr. SECOND CALL ACCOUNT. Cr.

19..			£	19..			£
	To Share Capital Account		5,000	Dec. 1	By Cash . . .		4,975
					" Forfeited Shares Account . .		25
			£5,000				£5,000

Dr. FORFEITED SHARES ACCOUNT. Cr.

19..			£	19..			£
Dec. 1	To Call Accounts . .		75	Dec. 1	By Share Capital Account		100
"	" Balance . . .	c/d.	25				
			£100				£100
				19.. Dec. 1	By Balance . . .	b/d.	25

The capital items would appear in the Balance Sheet thus :—

	£	£
Authorised Capital :—		
20,000 Ordinary Shares of £1 each . . .	20,000	
Issued Capital :—		
20,000 Ordinary Shares of £1 each, fully called .	20,000	
Less Shares forfeited	100	
		19,900
Forfeited Shares Account		25

NOTE.—For examination purposes one compound journal entry can be used to record the forfeiture of the shares, viz. :—

		£	£
Share Capital Account . .	*Dr.*	100	
To First Call Account . . .			50
" Second Call Account . . .			25
" Forfeited Shares Account . .			25

If, as is usual, the directors have power to reissue the forfeited shares, they may do so by selling them to a new purchaser for any sum they can obtain which, together with the amount previously received from the original holder, is not less than the called-up value of the shares on the date when they are reissued.

Upon reissue the necessary entries are :—

(1) Debit Forfeited Shares Account and credit Share Capital Account, with the total amount called up on the shares reissued.

(2) Debit Cash and credit Forfeited Shares Account with the amount received from the new purchaser.

If the amount payable on reissue is the same as the amount unpaid by the original member, plus the amount of any calls made since the date of forfeiture, the Forfeited Shares Account will be closed by the above entries, but if the new purchaser agrees to pay more than this amount, the account will still show a credit balance which represents a profit on the reissue of the shares; this should be transferred to a Premium on Forfeited Shares Reissued Account or to Premium on Shares Account, and shown as a separate item on the Balance Sheet.

EXAMPLE.

The shares forfeited in the example on page 309 are reissued, on 31st December, to A. Jones, on payment by him of 16s. per share. Show the journal entries recording the reissue, write up the Share Capital and Forfeited Shares Accounts, and show how the Balance Sheet items given on page 310 are affected by the reissue.

JOURNAL.

19..		£	£
Dec. 31	Forfeited Shares Account . . . . *Dr.*	100	
	To Share Capital Account		100
	Being reissue of 100 *shares, previously forfeited, to A. Jones, as per resolution of the directors dated* ...., 19..		
„ „	Cash . . . . *Dr.*	80	
	To Forfeited Shares Account		80
	Being cash paid by A. Jones in respect of the above 100 *shares, issued at* 16*s. per share.*		
„ „	Forfeited Shares Account . . . . *Dr.*	5	
	To Premium on Forfeited Shares Reissued Account [or Premium on Shares Account] .		5
	Being transfer of profit of 1*s. per share on reissue of the above shares.*		

Dr. SHARE CAPITAL ACCOUNT. Cr.

19..			£	19..			£
Dec. 31	To Balance . .	c/d.	20,000	Dec. 1	By Balance . . .	b/d.	19,900
				,, 31	,, Forfeited Shares Account . .		100
			£20,000				£20,000
				19..			
				Dec. 31	By Balance . . .	b/d.	20,000

Dr. FORFEITED SHARES ACCOUNT. Cr.

19..			£	19..			£
Dec. 31	To Share Capital Account		100	Dec. 1	By Balance . . .	b/d.	25
,,	,, Premium on Forfeited Shares Reissued Account . .		5	,, 31	,, Cash . . .		80
			£105				£105

Dr. PREMIUM ON FORFEITED SHARES REISSUED ACCOUNT. Cr.

				19..			£
				Dec. 31	By Forfeited Shares Account . .		5

After the reissue of the forfeited shares, the Balance Sheet will show the following items :—

	£	£
Authorised Capital : —		
20,000 Ordinary Shares of £1 each .	20,000	
Issued Capital :—		
20,000 Ordinary Shares of £1 each, fully paid		20,000
Premium on Forfeited Shares Reissued Account .		5

NOTE.—For examination purposes one compound journal entry can be used to record the reissue of the forfeited shares, viz. :—

		£	£
Cash	Dr.	80	
Forfeited Shares Account . .	Dr.	25	
To Share Capital Account . .			100
,, Premium on Forfeited Shares Reissued Account . . .			5

The reissue of forfeited shares is sometimes dealt with by means of a "Shares Reissued Account." This method is used in the example on page 319 but the procedure already described is recommended for examination purposes.

When the shares forfeited were originally issued at a premium, the premium applicable to those shares should be debited to Premium on Shares Account and credited to Forfeited Shares Account, in order that the balance of the Premium on Shares Account may only relate to the shares represented by the balance remaining on Share Capital Account. If any of the shares are reissued, Premium on Shares Account will be re-credited with the premium applicable to those shares.

EXAMPLE.

The X. Y. Z. Co., Ltd., has an authorised capital of 20,000 shares of £1 each. All the shares are issued on the following terms :—

Payable on Application .	5s. per share (including portion of premium —2s. 6d. per share).
Payable on Allotment . .	5s. per share (including balance of premium —2s. 6d. per share).
First Call	10s. per share.
Second Call . . .	5s. per share.

All calls have been made and paid in full with the exception of the second call on 100 shares allotted to H. Gordon. These shares were duly forfeited by the directors, and later, 60 shares were reissued to S. Leslie for 10s. per share. Show the Journal entries and ledger accounts recording the forfeiture and reissue.

JOURNAL.

	£	£
Share Capital Account . . . . Dr.	100	
Premium on Shares Account . . ,,	25	
To Forfeited Shares Account . . .		125
Being forfeiture of 100 shares allotted to H. Gordon for non-payment of second call of 5s. per share, as per directors' resolution of this date . . .		
Forfeited Shares Account . . . Dr.	25	
To Second Call Account. . . .		25
Being transfer of call unpaid on forfeiture of the above shares.		
Forfeited Shares Account . . . Dr.	75	
To Share Capital Account . . .		60
,, Premium on Shares Account . .		15
Being reissue of 60 shares, previously forfeited, to S. Leslie.		
Cash . . . . Dr.	30	
To Forfeited Shares Account . . .		30
Being payment of 10s. per share for shares issued to S. Leslie.		
Forfeited Shares Account . . . Dr.	15	
To Profit on Reissued Shares . . .		15
Being profit on 60 shares reissued . .		

Dr. SHARE CAPITAL ACCOUNT. Cr.

		£			£
To Forfeited Shares Account . .		100	By Application and Allotment Account .		5,000
,, Balance . . .	c/d.	19,960	,, First Call Account .		10,000
			,, Second Call Account		5,000
			,, Forfeited Shares Account . .		60
		£20,060			£20,060
			By Balance . .	b/d.	19,960

Dr. SECOND CALL ACCOUNT. *Cr.*

		£			£
To Share Capital Account		5,000	By Cash . . .		4,975
			„ Forfeited Shares Account . .		25
		£5,000			£5,000

Dr. FORFEITED SHARES ACCOUNT. *Cr.*

		£			£
To Second Call Account .		25	By Share Capital Account		100
„ Share Capital Account		60	„ Premium on Shares Account . .		25
„ Premium on Shares Account . .		15	„ Cash . . .		30
„ Profit on Reissued Shares Account .		15			
„ Balance . . .	*c/d.*	40			
		£155			£155
			By Balance . . .	*b/d.*	40

Dr. PREMIUM ON SHARES ACCOUNT. *Cr.*

		£			£
To Forfeited Shares Account . .		25	By Application and Allotment Account .		5,000
„ Balance . . .	*c/d.*	4,990	„ Forfeited Shares Account . .		15
		£5,015			£5,015
			By Balance . . .	*b/d.*	4,990

Dr. PROFIT ON REISSUED SHARES ACCOUNT. *Cr.*

					£
			By Forfeited Shares Account . .		15

NOTE.—The balance of £40 carried forward on Forfeited Shares Account represents the amount received on the 40 shares forfeited and not yet reissued, made up of :—

	£
Premium, 40 × 5s.	10
Application and Allotment Moneys, 40 × 5s.	10
First Call, 40 × 10s.	20
	£40

The profit of £15 on the reissue of the 60 shares may be proved in the following manner :—

	£
Ignoring the premium (since, upon reissue, this is re-credited to Premium on Shares Account) the Company received from H. Gordon application, allotment and first call moneys = 60 × 15s.	45
It also received from S. Leslie 60 × 10s.	30
	75
The Shares were reissued as fully paid up	60
Leaving a profit to the Company of	£15

When the shares forfeited were originally issued at a discount, the discount applicable to those shares should be credited to Discount on Shares Account and debited to Forfeited Shares Account, in order that the balance on Discount on Shares Account may only refer to the shares represented by the balance remaining on Share Capital Account. If any of the shares are reissued, Discount on Shares Account will be re-debited with the discount applicable to those shares.

The Issue of Debentures.

An issue of debentures is treated in a manner very similar to that necessitated by an issue of shares. A prospectus is prepared and issued, application and allotment sheets are compiled, allotment letters are issued, and so on, in the same way as for an issue of shares. Similarly, a Register of Debenture Holders is opened in the same manner as a Register of Members. Any premiums received on an issue of debentures should be treated in a similar manner to premiums on shares.

It must be borne in mind, however, that while this similarity exists, the status of shareholders differs from that of debenture holders. A shareholder is a member (i.e., a part proprietor) of the company, but a debenture holder is merely a creditor, secured or unsecured according to whether the debentures are mortgage debentures or not. Furthermore, debenture interest is a charge payable irrespective of whether profits are made or not, and must be debited to Profit and Loss Account, and *not* to Appropriation Account.

Debentures may be issued at a price below their face value, that is, at a discount, without any statutory restriction, but the liability of the company is for the full amount of the debentures, and, therefore, the full amount must be shown as a liability in the company's books and accounts. The amount of the discount is debited to a Debenture Discount Account, and must be shown, separately, as a fictitious asset in the Balance Sheet until written off. This discount is usually written off out of profits during the life of the debentures, e.g., where debentures are to be redeemed at the end of say ten years then one-tenth of the discount will be written off annually. If, however, the debentures are to be redeemed by annual drawings, this calls for different treatment,

as the discount should be written off in proportion to the debentures outstanding, as it is only equitable that the years which enjoy the use of the larger proportion of cash should bear the larger proportion of discount. This latter method is usually referred to as the "equated method" of writing off debenture discount. An example, illustrating the treatment of discount on debentures, is shown below.

EXAMPLE

On the 1st January, 19.., a company issued 30 6% Mortgage Debentures of £100 each, at a discount of 5%, repayable at par in equal proportions at the end of 5, 10, and 15 years. The articles of the company prohibit the reissue of redeemed debentures.

Show how the Debentures Account and the Debenture Discount Account would appear in the company's ledger, and also how the figures would appear in the Balance Sheet at the end of the 1st, 5th, and 10th years. Assume the discount has been written off proportionately over the various periods the debentures were in existence, i.e., according to the outstanding liability to the debenture-holders.

Dr. 6% MORTGAGE DEBENTURES ACCOUNT. *Cr.*

			£				£
5th Year				1st Year			
Dec. 31	To Cash .		1,000	Jan. 1	By Cash .		2,850
" 31	" Balance	*c/d.*	2,000	" 1	" Debenture Discount Account		150
			£3,000				£3,000
10th Year				6th Year			
Dec. 31	To Cash		1,000	Jan. 1	By Balance	*b/d.*	2,000
" 31	" Balance .	*c/d.*	1,000				
			£2,000				£2,000
15th Year				11th Year			
Dec. 31	To Cash .		1,000	Jan. 1	By Balance	*b/d.*	1,000

Dr. DEBENTURE DISCOUNT ACCOUNT. *Cr.*

		£			£
1st Year			Dec. 31		
Jan. 1	To 6% Debentures	150	1st Year	By Profit and Loss Account .	15
			2nd "	" " "	15
			3rd "	" " "	15
			4th "	" " "	15
			5th "	" " "	15
			6th "	" " "	10
			7th "	" " "	10
			8th "	" " "	10
			9th "	" " "	10
			10th "	" " "	10
			11th "	" " "	5
			12th "	" " "	5
			13th "	" " "	5
			14th "	" " "	5
			15th "	" " "	5
		£150			£150

The entries in the Balance Sheets will appear as follows :—

AT END OF 1ST YEAR, 31ST DECEMBER, 19..

Liabilities.	£	£	*Assets.*	£	£
6% Mortgage Debentures .		3,000	Debenture Discount .	150	
			Less amount written off . . .	15	
					135

AT END OF 5TH YEAR, 31ST DECEMBER, 19..

Liabilities.	£	£	*Assets.*	£	£
6% Mortgage Debentures .	3,000		Debenture Discount .	150	
Less redeemed .	1,000		*Less* amount written off . . .	75	
		2,000			75

AT END OF 10TH YEAR, 31ST DECEMBER, 19..

Liabilities.	£	£	*Assets.*	£	£
6% Mortgage Debentures .	3,000		Debenture Discount .	150	
Less redeemed .	2,000		*Less* amount written off . . .	125	
		1,000			25

At the end of the fifteenth year, the whole of the debentures have been redeemed and the debenture discount entirely written off ; hence no further entries will appear in later Balance Sheets.

In order to arrive at the correct proportion of discount on debentures to be written off in any particular year, the yearly periods during which the debentures are redeemable are reversed. Thus in the above example the ratio of the years is 15, 10 and 5, that is, a total of 30. The first period of five years then bears 15/30ths of the discount on debentures, the second period 10/30ths, and the third period 5/30ths. The actual effect of this method will be obvious from a perusal of the Debenture Discount Account (see page 316).

If the debentures had been repayable by equal annual amounts over five years, the annual proportions of discount written off would have been 5/15ths, i.e. $5 \div (1+2+3+4+5)$, 4/15ths, and so on. If the debentures had been repayable by equal amounts half-yearly over the five years, the ratio is obtained by doubling the number of years, thus the annual proportions of discount written off would have been 19/55ths, 15/55ths, and so on, to 3/55ths in the last year.

In some cases, debentures are issued at par and redeemed at a premium ; the treatment of these transactions is dealt with in the next chapter in connection with sinking funds.

Debentures are sometimes issued as collateral security, e.g., they may be lodged with bankers as security for a fluctuating overdraft. A collateral security is one which can be realised by the party in possession in the event of the original loan not being

repaid at the due date or in the event of other breach of agreement between the parties. Where debentures are issued in this manner, the authorisation for the issue is recorded in the company's Minute Book, and, when the issue is made, it is recorded in the Register of Mortgages and Charges and filed with the Registrar of Companies, but no entry is required in the books of account as no money is directly received for the debentures. The overdraft from the company's bankers is shown in the books in the usual way, while the fact of the debentures being issued and outstanding is shown in the Balance Sheet in the following manner :—

LIABILITIES SIDE OF BALANCE SHEET.

Bank Overdraft £5,470 10 0
(Collaterally secured by issue of £6,000 First Mortgage Debentures.)

The ruling of a Register of Mortgages varies according to circumstances, but the following is a simple form :—

REGISTER OF MORTGAGES.

Board Minute No. and date when mortgage was created.	Date of issue.	Date particulars filed with Registrar of Companies.	Amount.	Names of Mortgagees.	Particulars of Property charged.	Date of Redemption
193 . Jan. 1	193 . Jan. 1	193.. Jan. 8	£ 3,000	Names of persons to whom issued will appear in this column.	Floating charge on the whole of the company's assets present and future.	£ 1,000, 31st Dec., 19.. 1,000, 31st Dec., 19.. 1,000, 31st Dec., 19..
						£3,000

NOTE.—Where a trust deed is entered into with trustees on behalf of the debenture holders, only the names of the trustees are entered in this book.

If debentures have been redeemed but are capable of reissue, this fact must be stated on every Balance Sheet (Section 75).

The Issue of Different Classes of Shares.

Where different classes of shares are issued it is necessary to keep the accounts and records for each class of share quite distinct, and, accordingly, separate application and allotment sheets, separate call sheets, and separate share ledgers are compiled. It is customary to adopt distinctive colours for the application forms, allotment and call letters, share certificates, etc., so that the risk of confusion or wrong entries is reduced to a minimum. The bindings of the registers also are usually different in colour, but one combined index to all the registers is used in order that it may be easily ascertained whether a shareholder is interested in more than one class of share (see also page 272).

Similarly, separate application and allotment accounts, separate call accounts, and separate share capital accounts are raised in the General Ledger for each class of share, and this separation applies also to debentures. For examination purposes, where more than one class of share capital is issued, and it is

desired to show ledger accounts, they may be conveniently shown in columnar form as illustrated on page 321. In most cases, however, journal entries for the transactions (including cash) and a summary of the capital as it will appear in the Balance Sheet are all that are required from examinees. Candidates should, however, read the examination question carefully to ascertain exactly what form the answer should take.

A COMPREHENSIVE EXAMPLE.

On 1st March, 19.., a limited liability company was registered with a nominal capital of £200,000, divided into 120,000 Ordinary Shares of £1 each and 80,000 8% Preference Shares of £1 each. The consideration payable to the vendors was £40,000 in Ordinary Shares. On 1st March, 19.., the company offered for public subscription 60,000 Ordinary Shares of £1 each and 50,000 8% Preference Shares of £1 each, payable as follows:—

Ordinary	*Preference.*	
5s. per share	5s. per share	on Application.
5s. ,,	5s. ,,	,, Allotment.
10s. ,,	5s. ,,	,, one month after Allotment
	5s. ,,	,, two months ,, ,,

4,000 6% Mortgage Debentures of £10 each were also offered at par, payable 25% on application, 25% on allotment, and the balance in equal instalments at one and two months after allotment.

The whole issue, which was underwritten at a commission of 5%, was fully subscribed and allotment was made on 15th March, 19... On 15th December, 19.., under the Articles of Association, the directors forfeited 1,000 Preference Shares upon which 15s. had been paid, and on 28th December, 19.., reissued the forfeited shares upon payment of arrears plus a premium of 2s. 6d. per share. The calls in arrear on the Ordinary Shares amounted to £500. Draft the necessary entries recording the transactions in the company's books, and show how the credit balances arising therefrom would appear in the Balance Sheet on 31st December, 19..

JOURNAL

		Dr. £	*Cr.* £
19.. Mar. 15	Ordinary Application and Allotment Account . . . . . *Dr.* To Ordinary Share Capital Account . *Being amounts due on application* (5*s.*) *and allotment* (5*s.*) *per share on* 60,000 *Ordinary Shares, Nos. to , allotted this date.* (*Vide Minute Book, Resolution No. . . .*)	30,000	30,000
,, 15	Preference Application and Allotment Account . . . . . *Dr.* To Preference Share Capital Account . *Being amounts due on application* (5*s.*) *and allotment* (5*s.*) *per share on* 50,000 *Preference Shares, Nos. to , allotted this date.* (*Vide Minute Book, Resolution No. . . .*)	25,000	25,000
,, 15	Debenture Application and Allotment Account . . . . . *Dr.* To 6% Mortgage Debentures Account . *Being amounts due on application* (25%) *and allotment* (25%) *on* 4,000 *Debentures of* £10 *each, allotted this date.* (*Vide Minute Book, Resolution No. . . .*)	20,000	20,000

JOURNAL—*continued*

19..		Dr. £	Cr. £
Mar. 15	Sundry Assets . . . . . . Dr.	40,000	
	To Vendors		40,000
	Being assets acquired as per contract dated ...., 19..		
,, 15	Vendors . . . . . . Dr.	40,000	
	To Ordinary Share Capital Account .		40,000
	Being allotment of 40,000 Ordinary Shares of £1 each credited as fully paid in satisfaction of purchase price. (Vide Minute Book, Resolution No....)		
,, 15	Underwriting Commission Account . Dr.	7,500	
	To Underwriters		7,500
	Being amounts due to underwriters for commission, viz. :— £		
	5% on £60,000 Ord. Cap. 3,000		
	5% on £50,000 Pref. Cap. 2,500		
	5% on £40,000 Debentures 2,000		
April 15	Ordinary First Call Account . . Dr	30,000	
	To Ordinary Share Capital Account .		30,000
	Being amount of call due this date.		
,, 15	Preference First Call Account . . Dr	12,500	
	To Preference Share Capital Account		12,500
	Being amount of call due this date.		
,, 15	Debenture First Call Account . . Dr	10,000	
	To Debentures Account . . .		10,000
	Being amount of call due this date.		
May 15	Preference Second Call Account . Dr.	12,500	
	To Preference Share Capital Account .		12,500
	Being amount of call due this date.		
,, 15	Debenture Second Call Account . Dr.	10,000	
	To Debentures Account . . .		10,000
	Being amount of call due this date.		
Dec. 15	Preference Share Capital Account . Dr.	1,000	
	To Sundries		
	Preference Second Call Account . .		250
	Forfeited Shares Account . . .		750
	Being forfeiture of 1,000 Pref. shares (15s. paid) for non-payment of final call of 5s. per share. (Vide Minute Book, Resolution No....)		
,, 28	Sundries . . . . . . Dr		
	To Sundries		
	Shares Reissued Account . . .	375	
	Forfeited Shares Account . . .	750	
	Preference Share Capital Account .		1,000
	Premium on Reissued Shares Account .		125
	Being reissue of shares previously forfeited (15s paid) at 7s. 6d. per share, and transfer of amount received in excess of par value.		

Dr. [EXTRACT FROM] CASH BOOK. *Cr.*

19..		£	19..		£
Mar. 1	To Ordinary Applications . . .	15,000	Mar. 15	By Underwriters .	7,500
	„ Preference Applications . . .	12,500			
	„ Debenture Applications . . .	10,000			
„ 15	„ Ordinary Allotments . . .	15,000			
	„ Preference Allotments . . .	12,500			
	„ Debenture Allotments . . .	10,000			
Apr. 15	„ Ordinary First Call . . .	29,500			
	„ Preference First Call . . .	12,500			
	„ Debentures First Call . . .	10,000			
May 15	„ Pref. Second Call .	12,250			
	„ Deb. Second Call .	10,000			
Dec. 28*	„ Shares Reissued .	375			

Dr. APPLICATION AND ALLOTMENT ACCOUNT. *Cr.*

			Ordinary.	Preference.	Debentures.				Ordinary.	Preference.	Debentures.
19..			£	£	£	19..			£	£	£
Mar. 15	To Share Capital .		30,000	25,000		Mar. 1	By Cash . .		15,000	12,500	10,000
„ 15	„ Debentures .				20,000	„ 15	„ „ . . .		15,000	12,500	10,000
			£30,000	£25,000	£20,000				£30,000	£25,000	£20,000

Dr. FIRST CALL ACCOUNT. *Cr.*

			Ordinary.	Preference.	Debentures.				Ordinary.	Preference.	Debentures
19..			£	£	£	19..			£	£	£
Apr. 15	To Share Capital .		30,000	12,500		Apr. 15	By Cash . .		29,500	12,500	10,000
„ 15	„ Debentures .				10,000	Dec. 31	„ Balance . .	c/d.	500		
			£30,000	£12,500	£10,000				£30,000	£12,500	£10,000
Dec. 31	To Balance . .	b/d.	500								

Dr. SECOND CALL ACCOUNT. *Cr.*

		Preference.	Debentures.			Preference.	Debentures.
19..		£	£	19..		£	£
May 15	To Share Capital . .	12,500		May 15	By Cash . .	12,250	10,000
„ 15	„ Debentures .		10,000	Dec. 15	„ Forfeited Shares	250	
		£12,500	£10,000			£12,500	£10,000

Dr. SHARE CAPITAL ACCOUNT. *Cr*

			Ordinary	Preference.				Ordinary.	Preference.
19..			£	£	19..			£	£
Dec. 15	To Forfeited Shares .			1,000	Mar. 15	By Application and Allotment . .		30,000	25,000
,, 31	,, Balance. . .	*c/d.*	100,000	50,000	,, 15	,, Vendors . . .		40,000	
					Apr. 15	,, First Call . .		30,000	12,500
					May 15	,, Second Call .			12,500
					Dec. 28	,, Forfeited Shares Reissued . .			1,000
			£100,000	£51,000				£100,000	£51,000
					Dec. 31	By Balance . .	*b/d.*	100,000	50,000

Dr. DEBENTURES ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 31	To Balance	*c/d.*	40,000	Mar. 15	By Application and Allotment .		20,000
				Apr. 15	,, First Call		10,000
				May 15	,, Second Call		10,000
			£40,000				£40,000
				19..			
				Dec. 31	By Balance. . . .	*b/d.*	40,000

Dr. FORFEITED SHARES ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 15	To Pref. Second Call		250	Dec. 15	By Pref. Share Capital .		1,000
,, 28	,, Pref. Share Capital .		1,000	,, 28	,, Shares Re-issued .		375
,, 28	,, Premium on Forfeited Shares Re-issued .		125				
			£1,375				£1,375

Dr. SHARES REISSUED ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 28	To Share Capital .		375	Dec. 28	By Cash . .		375

Dr. PREMIUM ON REISSUED SHARES ACCOUNT. *Cr.*

				19..			£
				Dec. 28	By Forfeited Shares		125

Dr. VENDORS' ACCOUNT. *Cr*

19..			£	19..			£
Mar. 15	To Share Capital .		40,000	Mar. 15	By Sundry Assets.		40,000

Dr. SUNDRY ASSETS ACCOUNT. *Cr.*

19.. Mar. 15	To Vendors	£ 40,000			

Dr. UNDERWRITING COMMISSION ACCOUNT. *Cr.*

19.. Mar. 15	To Underwriters	£ 7,500			

Dr. UNDERWRITERS' ACCOUNT. *Cr.*

19.. Mar. 15	To Cash	£ 7,500	19.. Mar. 15	By Underwriting Commission	£ 7,500

EXTRACT FROM BALANCE SHEET

As at 31st December, 19..

Liabilities.	£	£
AUTHORISED CAPITAL :		
120,000 Ordinary Shares of £1 each	120,000	
80,000 8% Preference Shares of £1 each	80,000	
		200,000
ISSUED CAPITAL :		
100,000 Ordinary Shares of £1 each, fully called	100,000	
Less calls in arrear	500	
	99,500	
50,000 8% Preference Shares of £1 each, fully paid	50,000	
		149,500
DEBENTURES ISSUED :		
4,000 6% Mortgage Debentures of £10 each		40,000
Premium on Forfeited Shares Reissued Account		125

EXERCISE 8

A. Explain the meaning of the following terms :—

Authorised Capital; Issued Capital; Paid-up Capital; Reserve Capital; Mortgage Debentures; Memorandum of Association; Shares: Preference Shares; Cumulative Preference Shares; Deferred Shares. Out of what circumstances do the latter usually arise?

B. The Ixion Motor Company, Limited, has recently received £1,000 in respect of premiums on the issue of its shares. How should such premiums be dealt with? What would be the effect, from a financial point of view, of treating such premiums as revenue profits?

C. Can shares be redeemed? If so, under what circumstances?

D. What is meant by the "Statutory Report"? What are its contents, and what formalities must be complied with in respect of it?

E. Green & Co., Ltd., was formed with a Nominal Capital of £100,000, divided into 50,000 Ordinary Shares of £1 each, and 50,000 7% Preference Shares of £1 each. The Company was entitled to commence business on 1st March, 19.. Of the capital, 36,715 Ordinary Shares were applied for and allotted, and 5s. per share payable upon application, and 5s. per share on allotment had been duly received, and 10,000 Ordinary Shares, and 5,000 Preference Shares had been allotted as fully paid to the vendor under an agreement for sale. In addition 27,314 Preference Shares had been applied for and allotted, 7s. 6d. per share payable upon application, and 7s. 6d. per share upon allotment had been received with the exception of the allotment money on 1,000 shares.

You are required to prepare the Statutory Report, assuming that the following payments had been made before the date of the report:—

Preliminary expenses, £3,280.
Purchase of plant, £7,460.
Purchase of buildings, £8,672.
Directors' Fees, £105 (£21 each director)
General and office expenses, £189.

The balance of cash was at the bank on current account.

F. From the undermentioned particulars prepare the Statutory Report, in conformity with Section 113 of the Companies Act, 1929, of E. J. Smith & Sons, Ltd.

Directors—Horace Smith.
Edward Smith.
Peter Ludlow.
Auditors—Horsham, Coolhurst & Company.
Secretary—Henry Day.
Manager—Clarence Jordan.

40,000 shares of £1 each had been applied for and allotted. 5s. per share payable on application, and 5s. per share on allotment had been received.

The payments made prior to the date of the Report were:—

	£
Preliminary Expenses	1,000
(On account of estimated expenses, £2,000)	
Printing and Stationery	170

No modified contracts required to be submitted to the meeting for its approval.

Append the Auditors' Certificate.

G. A limited company decides to forfeit 1,000 £1 shares owing to non-payment of the final call of 10s. per share. Describe the procedure, and set out the entries necessary to give effect to the above.

H. A company issued 25,000 shares of £1 each and called up the full amount. The last two calls of 5s. each on 600 shares not having been paid the shares were forfeited. Draft the journal entries recording the forfeiture and show how the share capital will subsequently appear in the company's Balance Sheet.

I. A company issued 100 6% Mortgage Debentures of £100 each at a discount of 5%, repayable in 20 years at par. These debentures were all taken up.

Give the entries necessary to record the issue and show how they would appear in the company's Balance Sheet on 30th June, 19.. assuming that the issue was made on 1st July, 19..

J. Messrs Shaw, Ltd., made an offer to the public of 100,000 Ordinary Shares of £1 each at par. The terms of the issue were :—

5s. per share on application.
5s. per share on allotment.
10s. per share one month after allotment.

Applications were numerous, and the issue was about three times over-subscribed. You are requested to draft an application and allotment sheet with a view to facilitating the work, not only before, but also after allotment

K. A limited company has issued £100,000 of debentures bearing interest at 8% per annum and redeemable at the option of the company at any time on 3 months' notice at a premium of 5%, and an authorised share capital of £450,000 in shares of £1 each, of which 300,000 have been issued and paid up, a dividend at the rate of 12½% per annum thereon being regularly paid. The company decides to redeem the debentures, and to issue the remaining 150,000 shares to its shareholders at 25s. per share. The premiums on shares are to be used in paying the premiums on redemption of debentures, and the balance transferred to Capital Reserve Account.

Give the journal entries recording the transactions, show the position of the Debenture and Share Capital Accounts when the transaction is completed, and state what is the amount of the additional financial resources available to the company by the operation.

L. The National Oxygen Company, Ltd., seeks and obtains from Messrs Kudos, Ltd., on 1st January, 19.. a loan of £50,000 for 2 years at 8 % per annum, interest payable half-yearly. The loan is secured by the issue of £58,000 First Mortgage Debentures as collateral security. What do you understand to be the meaning of the term "collateral security," as used thus ? Draft the entries in the books of The National Oxygen Co., Ltd., recording the transactions during the period, and show how the loan and collateral security should appear in the Balance Sheet.

M. The directors of a limited company, on 15th January, 19.. allotted to various applicants 250,000 shares of £1 each, on which 5s. was payable on application, 5s. on allotment, and 2s. 6d. per share, 1, 2, 3, and 4 months after allotment. Among the applicants and allottees was Henry Shipper, who was allotted 5,000 shares, out of the 8,000 shares for which he applied, and on which he paid the allotment money. The first call on the allotted shares was duly paid by the allottee, but on his failing to pay the call due on 15th March, 19.. the directors, on 10th April, 19.. decided to forfeit his shares, and to sell them to William Fletcher for £2,000 as paid up to the extent of 15s. per share.

Show the entries that should appear in the company's books of account and in the share ledger in connection with the transaction.

N. A company is floated having a nominal capital of £250,000, divided into 200,000 Ordinary Shares of £1 each, and 50,000 8% Preference Shares of £1 each. The directors proceed to allot as follows :—

Ordinary.	50,000 to the vendors issued as fully paid.
„	100,000 to the public, payable 10s. on application, 5s. per share on allotment, and 5s. per share six months after allotment.
Preference.	30,000 to the public, payable in the same manner as in the case of the Ordinary Shares.

Show how you would enter the above in the statutory and financial books of the company.

O. A trader disposes of his business to a limited company for £250,000, payable as to £100,000 in cash, £75,000 in debentures, and £75,000 in an equal number of Ordinary and Preference Shares of £1 each. The assets taken over are as follows :—

	£
Plant and Machinery	25,000
Stock	150,000
Book Debts	30,000
Patents	10,000
Goodwill	35,000

Record all the transactions in the books of the trader and of the company.

P. The Laguna Company, Limited, offered for subscription 100,000 shares of £1 each, payable 2s. 6d. per share on application, and 5s. per share on allotment. Applications were received for 115,000 shares. The deposits on 7,500 shares were returned to those persons to whom no shares were allotted. The deposits on the other 7,500 shares were carried forward to the Allotment Account, these subscribers having paid for more shares than were allotted to them. All the allotment money was received on the due date. Make the necessary entries in the company's Journal, Cash Book, and Ledger to record the above transactions.

Q. Explain briefly the uses of the Journal, and make journal entries to open the books in the following case :—

On 1st January, 19.., *A* and *B* turned their business into a limited company with a capital of 30,000 shares of £1 each. On that date the assets were :—

	£
Stock	10,000
Book Debts	15,000
Cash	1,000
Investments	4,000
Plant	3,000
Furniture	500
Goodwill	2,500

The liabilities, which were taken over by the new company, amounted to £6,000. *A* and *B's* capitals were £20,000 and £10,000 respectively, for which they took shares credited as fully paid.

R. Henry Souter wishes to enlarge his business, and arranges with F. Horsefall to invest a sum equal to his (Souter's) capital and form a company. It is agreed that the debtors (£6,000) shall be excluded, but the new company is to undertake to collect them for Souter, whose liabilities—£5,000—are to be paid out of this collection; if it prove insufficient, he is to make good the deficiency. Stock on hand is valued at £25,000; premises at £15,000, and the goodwill at £5,000. Souter is to receive in settlement £5,000 cash, and shares for the remainder.

Henry Souter's Balance Sheet at the date of the transfer shows :—

Liabilities.		*Assets*	
	£		£
Creditors	5,000	Premises	12,000
Capital	45,000	Stock	30,000
		Debtors	6,000
		Cash	2,000
	£50,000		£50,000

At the end of six months, £4,500 of the outstanding accounts has been collected and applied towards liquidating Souter's liabilities. It is then agreed that the company shall take over the remaining uncollected accounts (£6,000 *less* £4,500 collected) and assume the remaining liability on account of Souter's creditors (£5,000 *less* £4,500 paid).

Set out the entries to close the books of Henry Souter in accordance with agreement of sale and subsequent arrangements, assuming that the company takes over the cash shown in Souter's Balance Sheet. Open the books of the company, showing the entries therein as to the transactions of the company with Souter.

S. A limited company offers for subscription, on 15th January, 300,000 Ordinary Shares of £1 each at 5s. per share premium, payable as follows :—

On application	2s. 6d. per share	
On allotment (24th January)	5s. 0d. „	and 2s. 6d. premium
28th February	2s. 6d. „	and 2s. 6d. „
30th April	10s. 0d. „	

Applications are received for 432,300 shares. Applicants for 32,300 shares are refused, and amounts paid in respect thereof are refunded, leaving 400,000 applications to be dealt with. Of these, 240,000 from present shareholders are accepted in full, and, in respect of the balance, allotment is made *pro rata*. Excess paid on application is carried to the credit of amounts due on allotment.

Give the journal entries required to record these transactions.

T. The Hospital Sundries Company, Limited, is formed with a capital of 150,000 £1 Ordinary Shares to purchase the following assets at the values set out:

	£
Freehold Premises	30,000
Stock in Trade	25,000
Plant and Machinery	15,000
Sundry Debtors	10,000
Goodwill	20,000

The vendors agree to accept £75,000 in cash and the balance in fully paid shares. The balance of the shares is issued to the public and fully subscribed, being payable as follows :—

2s. 6d. per share on Application.
7s. 6d. „ „ Allotment.
5s. 0d. „ three months after Allotment
5s. 0d. „ six „ „ „

You are required to make the necessary journal and opening entries in the books of the company.

U. A limited company issued £100,000 new capital, consisting of 100,000 shares of £1 each. The price of issue was 25s. per share, payable, on application,

2s. 6d. per share; on allotment, 10s. per share (including 5s. per share premium), and the balance as and when called up by the directors. Applications were received for 140,000 shares. The directors made the following allotments :—

(a) Applications from sundry persons for 80,000 shares were allotted in full.

(b) Applications from sundry persons for 40,000 shares were allotted as to 50 per cent.

(c) Applications from sundry persons for 20,000 shares were declined with letters of regret.

Assume that all moneys, payable up to and including allotment, were duly paid, with the exception of the amount due on allotment on 1,000 shares included amongst those allotted in full.

Rule a suitable Application and Allotment Sheet, and enter the above particulars therein.

V. Bernard Dixon's Balance Sheet at 31st December was as follows :—

Liabilities		*Assets.*	
	£		£
Sundry Creditors	10,000	Property	100,000
Bills Payable	40,000	Plant and Machinery	50,000
Capital	315,000	Stock	150,000
		Debtors	60,000
		Bank	5,000
	£365,000		£365,000

A limited company was formed to purchase the business for the sum of £400,000, payable as follows: 5% Mortgage Debentures, £100,000; 8% Preference Shares, £100,000; £150,000 Ordinary Shares and the balance in cash, the company agreeing to take over all liabilities.

The registered capital of the company was £500,000, divided into 200,000 Preference Shares and 300,000 Ordinary Shares of £1 each.

50,000 Preference and 50,000 Ordinary Shares were offered for subscription to the public.

The preference shares were issued at par, payable 5s. on application, 5s. on allotment, and the balance one month after allotment.

The ordinary shares were issued at 25s. per share, payable 5s. on application, 10s. on allotment (including the premium), and 10s. one month after allotment.

The issued capital was fully subscribed, and the shares and debentures, including the vendor's, were allotted.

All calls were duly paid except the amount due on allotment and final instalment on 500 ordinary shares which were forfeited.

The company paid the vendor the amount due to him in cash, and also £7,000 for preliminary expenses.

Record the above transactions in the company's Ledger, and prepare a Balance Sheet showing the position of the company.

CHAPTER IX

THE ACCOUNTS OF LIMITED COMPANIES

BOOKS OF ACCOUNT; RESERVES, RESERVE FUNDS AND SINKING FUNDS; REDEMPTION OF DEBENTURES; REDEMPTION OF PREFERENCE SHARES; APPROPRIATION OF PROFITS; ALTERATIONS OF CAPITAL; TRADING ACCOUNT, PROFIT AND LOSS ACCOUNT AND BALANCE SHEET; HOLDING COMPANIES; VALUATION OF SHARES.

Books of Account.

THE recording of the ordinary trading transactions of limited companies is governed, to a certain extent, by Sections 122 and 274 of the Act.

Section 122 requires every company to cause proper books of account to be kept with respect to :—

(*a*) All sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place ;

(*b*) All sales and purchases of goods by the company ; and

(*c*) The assets and liabilities of the company.

The books of account must be kept at the registered office of the company or at such other place as the directors think fit, and are to be open at all times to inspection by the directors.

Section 274 provides that if a company which is wound up has not kept proper books of account throughout the period of two years immediately preceding the commencement of the winding up, every director or other officer of the company who was knowingly a party to or connived at the default of the company becomes, unless he shows that he acted honestly or that in the circumstances in which the business of the company was carried on the default was excusable, liable on conviction on indictment to imprisonment for a term not exceeding one year, or on summary conviction to imprisonment for a term not exceeding six months.

For the purposes of this section the term " proper books of account " is defined by the Act as such books or accounts as are necessary to exhibit and explain the transactions and financial position of the trade or business of the company, including books containing :—

(*a*) Entries from day to day in sufficient detail of all cash received and paid ;

(b) Statements of the annual stocktakings (where the business has involved dealings in goods); and (except in the case of goods sold by way of ordinary retail trade)

(c) Statements of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

Apart from any statutory provisions, however, practically all limited companies cause detailed records of their trading transactions to be kept in a similar manner to those of a sole trader or partnership in order that the true profits may be ascertained periodically and the financial position of the concern shown clearly.

The profits resulting from a company's operations are, however, dealt with in a different manner to those of a sole trader or partnership.

For example, in the case of partnerships the whole of the profits are divided in the agreed proportions between the partners, but in the case of companies the profits are seldom, if ever, wholly distributed. The practice is to distribute the larger portion of the profits by way of dividend among the proprietors (i.e., the shareholders), and to carry the balance forward to the ensuing period.

Moreover, in the case of partnerships the only reserves usually made, apart from those for depreciation, are for outstanding or contingent liabilities, whereas limited companies commonly create reserves and reserve funds, with a view to ensuring the financial stability of the undertaking during periods of trade depression, and for providing the additional working capital necessitated by an increasing turnover.

Reserves, Reserve Accounts and Reserve Funds.

The distinction between these terms and their proper usage is a matter upon which eminent accountants hold divergent opinions. In some quarters the view is held that the term *Reserve Account* relates only to the record in the financial books of the provision for:—

(1) Adjustments of expenditure or liabilities which have accrued but are unpaid, or for receipts in respect of items not yet due; and

(2) A loss or liability which it is anticipated will occur but which has not been definitely ascertained;

while the term *Reserve Fund* is applied to those accounts which record what are, in fact, accumulations of undivided or undistributed profits. The term "Reserve Fund" is used for all accounts of this nature quite irrespective of whether an equal

amount is invested separately outside the business or whether the fund is retained and used in the business.

Other equally eminent accountants consider that (*a*) the term *Reserve* is more correctly used for adjustments of known or expected liabilities ; (*b*) a *Reserve Account* is an account which records an accumulation of profits which are retained in the business ; while (*c*) a *Reserve Fund* is a similar appropriation of profits for which an equal amount is withdrawn from cash and separately invested. It certainly seems desirable that some distinction should be made in the names of the two classes of accounts, and in the writer's opinion the word *Fund* should not be used as part of the title of an account unless the balance of the account is actually represented by separate and distinct assets, e.g., investments.

It is generally understood that a *Reserve Account* consists of amounts set aside out of profits either for a specific purpose or for the general purpose of strengthening the financial position of a business by increasing its working capital ; a *Reserve Fund*, on the other hand, is created for a particular purpose, e.g., the renewal of a lease or the redemption of debentures, sums equal to the periodical appropriations from profits being invested separately, thereby creating an actual fund equal in amount to the reserve which will be available when required to replace the asset or redeem the liability.

Both forms of reserve will be shown as liabilities in the Balance Sheet, and, in the case of a Reserve Fund, the corresponding investment will be shown separately among the assets.

In addition, a reserve built up by appropriations of profits with the object of strengthening the financial position of a company is often known as a *General Reserve*. Such a reserve may be either retained within the business or invested in outside securities, although, as a rule, it is considered preferable to restrict the use of the term to the former class.

Reserve.

A RESERVE is a provision made out of Revenue when preparing financial accounts, for :—

(1) A liability accrued due but not otherwise brought into account, e.g., Rent due at the date of the accounts.
(2) That part of a payment which covers a period subsequent to the date of the accounts, e.g., Rates paid in advance.
(3) An amount set aside in order to provide for possible gains or losses, which are unascertainable at the date of balancing, e.g., Reserves for discounts receivable or bad debts.

The method of recording these reserves is indicated in Chapters IV and VII.

Reserve Account.

Surplus Profits.—It is usual for a company to refrain from distributing its profits "up to the hilt," and to transfer any surplus over what is needed for distribution to a Reserve Account (alternatively styled a General Reserve); this reserve will be available for the equalisation of dividends in future lean years or for the extinction of losses. As the amount of the Reserve Account is retained in the business, it has the effect of providing the company with additional working capital.

This is the most common example of the use of a Reserve Account.

The question of the advantages or disadvantages of retaining in the business the amount set aside, or of investing it in securities quite apart from the business, is not a matter upon which it is possible to lay down any hard-and-fast rules; the circumstances of each case must be ascertained and carefully considered before any definite decision can be given. It will often be found that a greater return may be obtained by using the amount reserved in the business itself, but the attendant disadvantage is the risk that the money may not be available to meet the contingency in respect of which the reserve was created. On the other hand, if the amount reserved is separately invested the capital value of the investment may depreciate, and it is almost certain that a smaller return by way of interest will necessarily result. If, however, the investment is carefully selected, there should be no reason why the money would not be readily available when needed. Both methods involve the retention and accumulation of profits, and the effect, whichever method is adopted, is to strengthen and enhance the financial position of the business.

Where the reserve or fund is raised to provide for known contingencies or liabilities, it is undoubtedly better that the amount should be independently invested to ensure that the amount required will be available at the due date. This class of reserve is more appropriately described as a Sinking Fund.

A Capital Redemption Reserve Fund must not be confused with the ordinary type of reserve fund. This special term is used in the Act in connection with the redemption of preference shares out of profits otherwise available for dividends (see page 273), and the term should be reserved exclusively for this type of fund. The amount standing to the credit of the Fund may not be utilised for dividend purposes and can only be reduced in the manner prescribed by the Act.

Sinking Funds.

A Sinking Fund may be defined as a fund, created out of profits and represented by specific investments, which is brought into existence for a special purpose, such as the replacement of a wasting asset at the expiration of its life, or the redemption of debentures. An example of the former was given in Chapter IV, under the title of "Depreciation Fund."

Debenture Redemption Fund.—In this case, an amount is set aside out of profits each year, and an equivalent amount is invested outside the business in gilt-edged securities and allowed to accumulate at compound interest, so that at the end of the period the investment will amount to the sum required to repay the debentures.

The amount to be set aside each year is debited to Profit and Loss *Appropriation* Account and credited to a Debenture Redemption Fund Account. When the equivalent amount is invested, this is credited to Cash and debited to a Debenture Redemption Fund Investment Account. On receipt of interest on the investment, the amount thereof is debited to Cash and credited to Debenture Redemption Fund Account, a similar amount being invested, and credited to Cash and debited to Debenture Redemption Fund Investment Account. Thus, it will be seen that the Debenture Redemption Fund Account and the Debenture Redemption Fund Investment Account will always stand at the same figure, the former appearing in the Balance Sheet as a liability and the latter as an asset.

When the investments are sold for the purpose of redeeming the debentures at maturity, Cash is debited with the amount realised and the Debenture Redemption Fund Investment Account is credited. Upon the redemption of the debentures, Cash is credited with the sum paid out and the Debenture Account is closed by a debit entry of a similar amount. There remains the Debenture Redemption Fund Account, and the credit balance on this account, representing the total appropriations from the Profit and Loss Account, is transferred to Reserve Account (or General Reserve).

It will invariably be found in practice that owing to market fluctuations, etc., the investments will realise either slightly more or slightly less than their book value, with the result that either a debit or a credit balance (representing either a loss or a profit on realisation) will be left on the Debenture Redemption Fund Investment Account. This balance should be transferred to Debenture Redemption Fund Account, and from thence to Reserve Account. The credit balance on Debenture Redemption Fund Account could be credited to Profit and Loss Account and distributed in dividends, but this method is most undesirable,

and in any event it is very unlikely that cash will be available for this purpose after the debentures have been repaid.

It is useful at this stage to compare by means of two simple examples the difference between the entries necessary to record a sinking fund created to redeem a liability, and one to replace an asset.

SINKING FUND TO REDEEM A LIABILITY

Position prior to sale of investments :—

Dr. INVESTMENT ACCOUNT. *Cr.*

			£				
19..	To Balance .		10,000	19..			

Dr. SINKING FUND ACCOUNT. *Cr.*

							£
					By Balance .		10,000

Dr. LIABILITY (e.g., DEBENTURES) ACCOUNT. *Cr.*

							£
					By Balance .		10,000

The entries on sale of investment may be summarised as follows :—

			Dr.	*Cr.*
			£	£
19..	Cash . . . . *Dr.* To Investment Account . . . . *Being Sale of Investment*		10,000	10,000
	Sinking Fund . . . . . . *Dr.* To Reserve Account . . . . . *Being Transfer of Sinking Fund*		10,000	10,000
	Liability (e.g., Debentures) Account *Dr.* To Cash . . . . *Being Repayment of Liability*		10,000	10,000

SINKING FUND TO REPLACE AN ASSET

Position prior to sale of investment :—

Dr. INVESTMENT ACCOUNT. *Cr.*

			£				
	To Balance .		10,000				

Dr. SINKING FUND ACCOUNT. *Cr.*

							£
					By Balance .		10,000

Dr. ASSET (e.g., LEASEHOLD PROPERTY) ACCOUNT. *Cr.*

			£				
	To Balance .		10,000				

The entries on sale of investment may be summarised as follows :—

		Dr.	Cr.
		£	£
19..	Cash . . . . *Dr.*	10,000	
	To Investment Account		10,000
	Being Sale of Investment		
	Sinking Fund Account . . . *Dr.*	10,000	
	To Old Asset Account		10,000
	Being Transfer of Sinking Fund		
	New Asset Account . . . *Dr.*	10,000	
	To Cash		10,000
	Replacement of Asset		

In the case of a sinking fund to replace an asset the fund is required to write off the old asset, whereas in the case of a fund to redeem a liability the fund remains as a credit balance in the books. There has, in the former case, been a definite loss of an asset, whereas no loss is incurred when a liability is redeemed.

Redemption of Debentures.

Debentures, unless stated to be irredeemable, are redeemed according to the terms of issue, e.g., by periodical drawings (see page 315), or by repayment on either the fixed date or subject to the necessary notice being given to the debenture-holders, at the option of the company. The requisite funds for the repayment of the debentures are usually obtained in the manner indicated in the previous section, or a new issue of debentures may be made on more advantageous terms, and the money received therefrom utilised in the repayment of the pre-existing debentures.

A modern development, consequent upon the existence of debentures bearing low rates of interest and thus standing at a discount in the market, is that by which a company purchases its own debentures in the open market. If they are not cancelled immediately, the debentures so purchased should appear as an asset in the Balance Sheet—" Company's Own Debentures (at cost price) £——" —until they are actually cancelled, when, of course, the nominal value of such debentures should be shown as a deduction from the original debenture issue on the liabilities side of the Balance Sheet. The redeemed debentures may be treated like other Sinking Fund Investments, if they are not immediately cancelled, the interest being dealt with similarly to income received from other sinking fund investments. The profit made on the purchase of the debentures, as represented by the difference between the cost price and the nominal value of the

debentures, should be transferred to Debenture Redemption Fund Account (or to Profit and Loss Account if the Articles permit, although to transfer to reserve is a more prudent policy).

The Act provides that a company has power to reissue debentures previously redeemed either by reissuing the same debentures, or by issuing others in their place, unless the Articles, any contract entered into by the company, a resolution or some other act of the company shows an intention that the debentures should be cancelled. Particulars of debentures capable of being so reissued must be included in the company's balance sheet.

The following is an example of the entries required when debentures are redeemed at a fixed date.

EXAMPLE.

The Suburban Company, Limited, showed in their accounts on 31st December, 19.., a Debenture Redemption Reserve Fund of £100,000, which was represented by an investment in 3½% War Loan of £102,000 (nominal). On the following 30th June the company's bank balance was £12,000, and the War Loan having been sold at 101 net, the proceeds were paid into the bank, and Debentures, amounting to £100,000, were paid off. Show by means of ledger accounts the entries in the books of the company in respect of the above transactions.

Dr. DEBENTURE ACCOUNT. Cr.

19..			£	19..			£
June 30	To Cash .		100,000	June 30	By Balance .	b/d.	100,000

Dr. DEBENTURE REDEMPTION FUND ACCOUNT. Cr.

19..			£	19..			£
June 30	To General Reserve .		103,020	June 30	By Balance .	b/d.	100,000
					„ Investment Account		3,020
			£103,020				£103,020

Dr. INVESTMENT ACCOUNT—3½% WAR LOAN. Cr.

19..			£	19..			£
June 30	To Balance (£102,000 Stock) .	b/d.	100,000	June 30	By Cash—Sale of £102,000 Stock .		103,020
	„ Profit transferred to Redemption Fund		3,020				
			£103,020				£103,020

Dr. GENERAL RESERVE ACCOUNT. Cr.

				19.. June 30	By Debenture Redemption Fund		£ 103,020

Dr. [EXTRACT FROM] CASH ACCOUNT. Cr.

			£				£
19.. June 30	To Balance .	b/d.	12,000	19.. June 30	By Debenture Account .		100,000
	„ Realisation of Investments .		103,020				

The following example illustrates the method adopted when the debentures are redeemed by purchase in the open market :—

EXAMPLE.

On 1st January, 1929, the X. Co., Ltd., issued £50,000 6% Debentures, to be redeemed on 31st December, 1949, or by purchase in the open market after 1st January, 1939, Sinking Fund Investments to be sold for this purpose. £1,000 was transferred annually to the Sinking Fund and invested with accrued interest, the balance on 31st December, 1939, being £11,200. During 1940, income amounting to £300 (net) was received from these investments and re-invested at the end of the year. The following investments were realised for the purpose of purchasing Debentures for immediate cancellation in 1940 :—

	Cost	*Realised*	*Nominal Value of Debentures Purchased*
1940	£	£	£
Feb. 1	1,000	1,100	1,150
Sept. 30 . . .	2,500	2,490	2,650

Show the ledger accounts required to record the above transactions during 1940. Ignore the question of accrued interest in the purchase price of the debentures.

Dr. DEBENTURE STOCK ACCOUNT. Cr.

			£				£
1940 Feb. 1	To Cash : Purchase of £1,150 (nominal) Debentures .		1,100	1940 Jan. 1	By Balance . .	b/d.	50,000
	„ Sinking Fund—Profit on Cancellation .		50				
Sept. 30	„ Cash : Purchase of £2,650 (nominal) Debentures		2,490				
	„ Sinking Fund—Profit on Cancellation .		160				
Dec. 31	„ Balance . .	c/d.	46,200				
			£50,000				£50,000
				1941 Jan. 1	By Balance . .	b/d.	46,200

Dr. DEBENTURE SINKING FUND ACCOUNT. *Cr.*

1940			£	1940			£
Sept. 30	To Investment Account		10	Jan. 1	By Balance	*b/d.*	11,200
Dec. 31	„ General Reserve		3,800	Feb. 1	„ Debenture Account		50
	„ Balance	*c/d.*	9,000	„ 1	„ Investment Account		100
				Sept. 30	„ Debenture Account		160
				Dec. 31	„ Cash : Interest on Investments		300
					„ Profit and Loss Account		1,000
			£12,810				£12,810
				1941			
				Jan. 1	By Balance	*b/d.*	9,000

Dr. DEBENTURE SINKING FUND INVESTMENTS. *Cr.*

1940			£	1940			£
Jan. 1	To Balance	*b/d.*	11,200	Feb. 1	By Cash—Realisation of Investments		1,100
Feb. 1	„ Sinking Fund—Profit on Realisation		100	Sept. 30	„ Cash—Realisation of Investments		2,490
Dec. 31	„ Cash		1,300		„ Sinking Fund—Loss on Realisation		10
				Dec. 31	„ Balance	*c/d.*	9,000
			£12,600				£12,600
1941							
Jan. 1	To Balance	*b/d.*	9,000				

Dr. GENERAL RESERVE ACCOUNT. *Cr.*

				1940			£
				Dec. 31	By Sinking Fund—Transfer of nominal value of Debentures redeemed		3,800

Redemption of Preference Shares.

The main features of Section 46 of the Act, which deals with the redemption of preference shares, are summarised below :—

(1) The shares are not to be redeemed unless they are fully paid—Subsection (1) (*b*).

(2) The shares can be redeemed only out of profits which would otherwise be available for dividend or out of the proceeds of a new issue of shares made for the purposes of redemption—Subsection (1) (*a*).

(3) Where the shares are redeemed out of profits there must be transferred to a "Capital Redemption Reserve Fund" a sum equal to the amount applied in redeeming the shares—Subsection (1) (*c*).

(4) This fund can be reduced only in accordance with the provisions of the Act relating to the reduction of capital except where bonus shares are issued to replace the shares redeemed—Subsections (1) (*c*) and (5).

(5) Where shares are redeemed out of the proceeds of a new issue, any premium payable on redemption must be provided out of profits before the shares are redeemed—Subsection (1) (*d*).

The reason underlying the different accounting entries under the two methods of redemption should be appreciated. The difference arises primarily out of the legislature's desire to safeguard the rights of the company's creditors by ensuring that the assets are not depleted. Where redemption takes place out of the proceeds of a new issue, working capital is not depleted; but when redemption takes place out of profits there is no inflow of new capital to replace that which has just been paid off. If the company were then permitted to distribute as dividend the profits out of which redemption of the redeemable preference shares had been effected, there would be a further drain on its assets, possibly to the detriment of creditors; hence (subject to certain provisions) the company is legally called upon to capitalise a portion of its profits equivalent to the amount applied in redeeming the shares. The transfer is of a similar nature to that made between Debenture Redemption Fund Account and Reserve Account when debentures have been redeemed (see page 333), except that in that case the transfer is made as a matter of prudent policy and not under statutory compulsion.

EXAMPLES.

I. Shares Redeemed at Par out of Profits.

In accordance with the terms of issue a company redeems 50,000 6% Preference Shares of £1 each at par out of profits otherwise available for dividend. Show by means of journal entries the records in the books of the company.

JOURNAL.

			£	£
19..	Redeemable Preference Share Capital Account . . . . . . *Dr.*		50,000	
	To Cash			50,000
	Being redemption of 50,000 6% Redeemable Preference Shares of £1 each at par in accordance with resolution dated............			
	Profit and Loss Appropriation Account *Dr.*		50,000	
	To Capital Redemption Reserve Fund .			50,000
	Being appropriation to reserve out of available profits of a sum equal to the amount applied in redeeming 50,000 Preference Shares of £1 each in accordance with Section 46 (1) (c) of the Companies Act, 1929, and resolution dated			

II. Shares Redeemed at Par out of Proceeds of New Issue of Shares.

In accordance with resolution dated............ a company decides to issue 50,000 Ordinary Shares of £1 each at par and utilise the proceeds to redeem 50,000 6% Preference Shares of £1 each at par. Assuming the new issue was fully subscribed and paid up, show by means of journal entries the records in the company's books.

JOURNAL.

			£	£
19..	Cash . . . . *Dr.*		50,000	
	To Ordinary Share Capital Account .			50,000
	Being issue of 50,000 Ordinary Shares of £1 each in order to provide funds for the redemption of Preference Shares amounting to £50,000			
	Redeemable Preference Share Capital Account . . . . . . *Dr.*		50,000	
	To Cash			50,000
	Being redemption of 50,000 6% Redeemable Preference Shares of £1 each in accordance with resolution dated..........			

Note.—Redemption may be effected out of the proceeds of a new issue of *any* class of shares—it need not be a new issue of Redeemable Preference Shares.

III. Shares Redeemed at a Premium out of Profits.

Assuming the shares in Example I are redeemed at a premium of 2s. 6d. per share, show by means of journal entries the records in the books of the company.

JOURNAL.

			£	£
19..	Sundries— *Dr.*			
	Redeemable Preference Share Capital Account		50,000	
	Premium on Redemption Account . .		6,250	
	To Cash			56,250
	Being redemption of 50,000 6% *Redeemable Preference Shares of* £1 *each at a premium of* 2*s.* 6*d. per share in accordance with the terms of issue and resolution dated..........*			
	Profit and Loss Appropriation Account *Dr.*		56,250	
	To Capital Redemption Reserve Fund .			56,250
	Being appropriation to reserve out of available profits of a sum equal to the amount applied in redeeming 50,000 6% *Preference Shares of* £1 *each in accordance with Section* 46 (1) (*c*) *of the Companies Act,* 1929, *and resolution, dated..........*			

NOTE.—Although it was probably the intention of the legislature that the transfer to Capital Redemption Reserve Fund should equal the nominal amount of the shares redeemed and that any premium should be written off to Profit and Loss Account, this is not apparent from a literal interpretation of the relevant section of the Act. The "amount applied" obviously includes the premium, and this interpretation has been followed in the above example, although it must not be overlooked that authorities differ as regards the practical application of this section. The premium paid will remain as a debit balance in the books and will be shown as a fictitious asset in the Balance Sheet until the company decides to write it off.

This procedure should be compared with the treatment of the premium when shares are redeemed out of the proceeds of a new issue, Section 46 (1) (*d*) specifically stating that the premium must be provided out of profits.

IV. Shares Redeemed at a Premium out of Proceeds of New Issue of Shares.

Assuming the shares in Example II are redeemed at a premium of 2s. 6d. per share, show by means of journal entries the records in the books of the company.

JOURNAL.

			£	£
19..	Cash . . . . *Dr.*		50,000	
	To Ordinary Share Capital Account .			50,000
	Being issue of 50,000 *Ordinary Shares of* £1 *each in order to provide funds for the redemption of Preference Shares amounting to* £50,000 [*premium not being provided for in accordance with the wording of the question*].			

JOURNAL—*Continued.*

19..		£	£
	Sundries— *Dr.*		
	Redeemable Preference Share Capital Account	50,000	
	Premium on Redemption Account . .	6,250	
	To Cash		56,250
	Being redemption of 50,000 6% *Redeemable Preference Shares of* £1 *each at a premium of* 2*s.* 6*d. per share in accordance with the terms of issue and resolution dated..........*		
	Profit and Loss Appropriation Account *Dr.*	6,250	
	To Premium on Redemption Account .		6,250
	Being provision out of profits of premium of 2*s.* 6*d. per share payable on redemption of* 50,000 6% *Preference Shares of* £1 *each in accordance with Section* 46 (1) (*d*) *of the Companies Act,* 1929, *and resolution dated......*		

NOTE —It will be seen, in this case, that the premium paid must be provided out of profits, but that the balance on this account is automatically eliminated.

It must not be overlooked that the compulsory creation of a Capital Redemption Reserve Fund may be effected by a series of transfers over the period of years during which the Redeemable Preference Shares are outstanding.

Shares may, of course, be redeemed partly out of profits and partly out of the proceeds of a new issue of shares made for the purpose, but the necessary entries are on similar lines to the foregoing examples. Any premium payable would, in such a case, be apportioned according to the number of shares redeemed out of profits and the number redeemed out of the proceeds of the new issue, in order to comply with Subsections (1) (*c*) and (1) (*d*) of Section 46.

A sinking fund might be established, the procedure being similar to a sinking fund for the redemption of debentures provided that the provisions of Section 46 are strictly followed.

If it is desired to reduce the Capital Redemption Reserve Fund the procedure must be in accordance with the provisions of the Act for reduction of capital. Bonus shares, may, however, be issued and the Capital Redemption Reserve Fund applied in paying up such shares.

Secret Reserves.

Another method which has the effect of strengthening a company's financial position is the establishment of secret reserves, i.e., reserves which are not disclosed on the face of the

published accounts. The more usual methods by which they are created are :—

(1) Charging capital expenditure to revenue ; for example, improvements and additions to buildings, machinery and plant, which in the ordinary way are capitalised, are charged against the current year's profits.
(2) The undervaluation of assets ; e.g., fixed assets, investments or stock-in-trade are valued much below cost or market price, while some very prosperous companies value "Goodwill," in their Balance Sheets, at a purely nominal figure (£1, in some cases).
(3) The creation of specific reserves in excess of actual requirements, e.g., excessive provision for depreciation or for bad debts.
(4) Grouping items on the liabilities side of the Balance Sheet, e.g., Reserves and Creditors, under a general heading such as "Sundry Creditors and other Credit Balances."

It will be noted that secret reserves may be secret either as to their *amount* (e.g., goodwill written down to the nominal value of £1), or as to their *existence* (e.g., a reserve for contingencies merged in the item "Sundry Creditors" in the Balance Sheet).

Although there is much to be said against the practice, secret reserves are often created by successful companies, and where abnormal profits have been realised in an exceptional year, it is probably quite a prudent course to adopt in order to establish the company upon a thoroughly sound basis. Such reserves, of course, should be fully disclosed to all the directors and to the auditors.

Again, where fixed assets have appreciated in value, it may almost invariably be taken to be the correct policy to allow them to appear in the Balance Sheet at their original book value. If such an asset is realised at a profit, such profit may be used to reduce the book value of the new asset acquired in replacement. Alternatively, the profit may be transferred to reserve; this method, however, necessitates disclosure in the accounts, unless the reserve is hidden among other liabilities, as in (4) above.

It is common knowledge that, in accordance with the practice of many other financial undertakings, banking and insurance companies value their investments upon a very conservative basis. The item "Bank Premises" in the Balance Sheets of banking companies is one which is usually shown much below the real market value. In the cases of such concerns continued success is largely dependent upon the retention of public confidence, and in the circumstances secret reserves serve a useful purpose.

It is the *use* to which secret reserves may be put **rather than**

their *creation* which gives rise to hostile criticism. Whilst the creation of secret reserves may be justified in certain circumstances, there is no justification for utilising the reserves to give an entirely fallacious impression of the profits being earned, or of the general prosperity of a company. If such accounts are used as the basis of statements in a prospectus for inviting subscriptions to shares or debentures, then the persons responsible for the misstatements may be held to be liable for misrepresentation.

Thus while the creation of secret reserves may be justified, provided such reserves are created in the *bona fide* interests of the company, it is suggested that full disclosure should be made in the published accounts when such reserves are utilised in augmenting the trading profits of the company.

The Distribution of Profits.

There are no statutory provisions in the Companies Act relating to the distribution of the profits of a company, the only regulations applicable being those contained in each company's articles of association. In Table A there are clauses relating to dividends, and although special articles may extend or vary these provisions, the principal clauses of Table A are usually retained.

The articles customarily provide that :—

(1) No dividend shall be paid otherwise than out of profits;
(2) The right to declare dividends shall be vested in the members in general meeting, but no dividend may be declared at a rate exceeding that recommended by the directors;
(3) The directors may pay such interim dividends as appear to be justified by the profits; and
(4) Before recommending any dividend the directors may transfer to reserve such sums as they deem desirable.

It will be seen, therefore, that the responsibility for the distribution of profits among the members rests primarily with the directors.

What are Divisible Profits?

The question of what are divisible profits is one that necessitates careful consideration, and in this connection the following extract from Lord Justice Buckley's well-known book on Company Law may be usefully quoted :—

> "The profits of an undertaking are not such sums as may remain after payment of every debt, but are the excess of revenue receipts over expenses properly chargeable to revenue account. As to what expenses are properly chargeable to capital, and what to revenue, it is necessarily impossible to lay down any general rule. In many cases, it may be for the shareholders to determine this for themselves, provided the determination be honest and within legal limits."

The legal aspect, however, is somewhat different from the commercial practice. It will be observed that the above extract

refers to the "excess of revenue receipts over expenses properly chargeable to revenue account," and in several cases which have been decided by the courts a sharp distinction has been made between the necessity of making good losses of Fixed and of Floating Capital. The general effect of these legal decisions is that, in some instances, profits may be distributed and dividends declared without making provision for the wastage of certain fixed assets.

Two of the leading cases on this point are *Lee* v. *Neuchatel Asphalte Co.*, 1889, and *Verner* v. *General and Commercial Trust*, 1894. In each of these cases it was held that the company had not exceeded its powers in declaring dividends without first writing down the book values of certain fixed assets. In the case of *Verner* v. *General and Commercial Trust* the company's business was that of an investment trust; the interest and dividends received on its investments were carried to the credit of revenue, and the balance of the Revenue Account was distributed as dividends without providing for depreciation of the capital value of the company's investments although the market value of some of them was greatly reduced. In the course of the judgment it was stated that :—

> "Fixed capital may be sunk and lost, and yet the excess of current receipts over current payments may be divided; but floating or circulating capital must be kept up."

It should be added, however, that in the cases referred to, the company's articles contained no clauses requiring the directors to make good capital losses out of revenue. Of course, it must be understood that any provisions in a company's articles requiring such losses to be made good are valid and binding, and that effect must be given to them.

While the legal position is that losses of fixed assets need not necessarily be provided for, yet from a commercial point of view such provision is absolutely essential to the prosperity and success of a *continuing* undertaking. Accordingly, the business practice is to make good the losses or wastage of such fixed assets as land and buildings, plant and machinery, etc., and ample reserves are made either by writing off the losses, or by raising sinking funds for their replacement, out of profits. On the other hand, when the fixed capital of a company is represented by such an inherently wasting asset as a gold mine, it is rarely found that any provision is made for the replacement of the capital by the time the mine is worked to exhaustion and is, therefore, valueless.

The reason for this is that such a company is usually formed for the specific purpose of exploiting the asset, and that the intention is to wind up when the said asset is worked out. The appropriation of profits in order to provide for depreciation would

therefore simply result in a fund being built up which would be returned to members on the dissolution of the company, and it is considered more equitable and convenient to pay a higher rate of dividend over the period of the company's existence. If all the members are aware of the true facts, and the regulations of the company contain no provisions to the contrary, the law will not interfere; and, indeed, there is no reason why it should do so.

Divisible profits may also, subject to three essential conditions, include profits of a capital nature. These conditions are:

(i) The profit must be realised (thus, an unrealised appreciation in the value of freehold premises cannot be credited to revenue);

(ii) There must be a surplus after the revaluation of all other assets (thus, if any other assets are over-valued in the books, this over-valuation must first be set against the surplus on the realised asset); and

(iii) The Articles of Association must permit the distribution of such a surplus (*Foster* v. *The New Trinidad Lake Asphalte Co.*, 1901; *Lubbock* v. *The British Bank of South America*, 1892).

But where an unrealised capital "appreciation" really represents the reinstatement of excessive depreciation written off the asset in previous years, the amount by which the asset is written up may be credited to Profit and Loss Account and thus made available for distribution (*Stapley* v. *Read Bros, Ltd.*, 1924).

Payment of Interest out of Capital.

Section 54 of the Act provides that where shares are issued for the purpose of raising funds for the construction of works, buildings, etc., which will not become revenue-earning for some considerable time, the company may pay interest on such paid-up capital and charge the said interest to capital as part of the cost of construction. No such interest may be paid, however, unless the payment is authorised by the company's articles, or by special resolution, and is sanctioned by the Board of Trade. The rate of interest must not exceed 4 per cent. per annum or such other rate as may for the time being be prescribed by Order in Council, and the period for which it is paid, which must be such as the Board of Trade determines, must not in any case extend beyond the close of the half-year next after the half-year during which the works were actually completed. The accounts of the company must clearly show the capital on which such interest is paid, and also the rate of interest.

The Companies (Interest out of Capital) Order, 1929, provides that the maximum rate of interest to be paid in pursuance of the above section shall in no case exceed 6 per cent. per annum, in place of the maximum rate of 4 per cent. specified in the section.

The payment of interest on share capital under the provisions of Section 54 does not amount to the payment of a dividend out of capital, for interest and dividends are essentially different in their nature. The interest is paid during a period in which the question of dividend payment could not arise, for before the works in course of construction become revenue-bearing there could be no fund of profits out of which a dividend could be paid.

Where loans, e.g., debentures, have been raised for capital purposes, the interest thereon may be paid out of capital, and that fact may be recognised in the accounts, i.e., by charging the interest so paid to the asset account. The interest is, of course, interest paid to a *creditor* and should be distinguished from interest paid to a *shareholder*, under Section 54.

Profits made Prior to Incorporation.

In many cases a company takes over a business from a date prior to its incorporation; for example, a company registered on the 1st February may acquire the vendor's business as from the 31st December of the previous year, the date on which the vendor's last balance sheet and accounts were compiled. From a legal point of view a company cannot earn profits prior to its incorporation, i.e., before it exists as a legal entity; moreover, the vendor's price for his business is usually fixed at such a figure as to include the amount of the estimated profits for the intervening period.

Such profits are not available for distribution; for to distribute them amongst shareholders would, in fact, amount to a payment of dividends out of capital, for it is to be presumed that the equivalent of those profits has already been paid to the vendor as part of the purchase price. Such profits should be placed to a special reserve, of a capital nature, and used for capital purposes only, e.g., the reduction of goodwill.

Sometimes, however, the vendor stipulates that the price agreed upon shall be for the business as at the date from which it is taken over, and the contract further provides for the payment of interest on the purchase money until the completion of the purchase is effected. In such cases, the interest payable up to the date of incorporation may be charged against any profits accruing prior to incorporation. These may be ascertained by taking stock and drawing up accounts at the date of incorporation, or, if this method is inconvenient, they must be ascertained approximately by apportioning over the two periods the profits shown in the accounts at the end of the first trading period.

There are two principal methods of apportionment, viz.:

(*a*) on the basis of turnover; and
(*b*) on the basis of time.

For example, a company was incorporated on the 1st February

and took over a business as from the previous 31st December. The profits for the first year were £3,000, the turnover for January being £4,000, and for the remaining eleven months £46,000. The apportionment may be made alternatively as follows :—

On the basis of turnover. This method gives the pre-incorporation profits as $\frac{4}{50}$ of £3,000 = £240, leaving £2,760 available for distribution.

On basis of time. By this method the pre-incorporation profits are $\frac{1}{12}$ of £3,000 = £250, leaving £2,750 available for distribution.

On the combined bases of turnover and time. A further method which is frequently used and which appears to give the best results is to apportion the gross profit according to the turnover during the respective periods, and the expenses according to time, the argument being that gross profits vary directly with the turnover, while expenses vary in proportion to the length of the periods, irrespective of the turnover in those periods. In certain cases, however, expenses do not vary in direct proportion to time, and it may be necessary to apportion each class of expense to the pre- and post-incorporation periods on its merits. Thus, travellers' commission and carriage outward should, as far as possible, be apportioned according to the pre- and post-incorporation sales of the classes of goods in respect of which they were incurred. Again, where certain expenses of a seasonal nature (e.g., heating and lighting) are heavy, an apportionment on a "flat" time basis would not give equitable results.

Expenses which are applicable to pre- or post-incorporation profits *only* (e.g., Partners' Salaries must have been incurred *before* incorporation, while Directors' Fees and Debenture Interest must have been incurred *after* incorporation) must be charged entirely against the profit applicable to the period to which they relate, no apportionment being possible.

EXAMPLE.

Johnsons, Limited, was incorporated on 30th June, 1940, to acquire the business of D. Fletcher & Son. The company was to take over the business as from 1st January, 1940, on the basis of the Balance Sheet, dated 31st December, 1939.

The accounts for the year ended 31st December, 1940, disclosed the following:—

The Trading Account showed a Gross Profit of £80,000.

The sales for the year amounted to £400,000 (1st January to 30th June, £180,000; 1st July to 31st December, £220,000).

The following expenses were debited to the Profit and Loss Account :—

Preliminary Expenses ($\frac{1}{5}$), £2,000; Directors' Fees, £1,500; Bad Debts, £1,640 (1st January to 30th June, £780; 1st July to 31st December, £860); Advertising, £3,600 (under a contract amounting to £300 per month); Salaries,

Depreciation, and General Expenses, £21,600; Underwriting Commission and Brokerage, £4,540.

The net profit for the year amounted to £45,120.

If, in your opinion, the whole of the above net profit was not available for distribution, prepare a statement showing how you would deal with it.

The amount of profits earned prior to incorporation are not available for distribution and should therefore be transferred to a Capital Reserve Account and utilised for capital purposes, e.g., reduction of goodwill.

	Prior to Incorporation.	*Subsequent to Incorporation.*
	£	£
Gross Profit apportioned according to turnover	36,000	44,000
Less Expenses:—		
Preliminary Expenses		2,000
Directors' Fees		1,500
Bad Debts	780	860
Advertising	1,800	1,800
Salaries, Depreciation, etc.	10,800	10,800
Underwriting Commission, etc.		4,540
	13,380	21,500
Net Profit	22,620	22,500
	£36,000	£44,000

Therefore an amount of £22,620 should be transferred to Capital Reserve Account, while the balance of £22,500 is available for distribution as dividend.

It should be noted that the expenses which relate solely to the company, are charged entirely against profits subsequent to incorporation.

Where a *loss* is incurred prior to incorporation the effect is to increase the purchase price to a corresponding extent, in that the net assets acquired are correspondingly reduced; thus such loss should be debited to Goodwill Account and written off as soon as profits are available. If it should happen that there is a loss prior to incorporation and a profit after incorporation, the former may be set off against the latter, thus reducing the divisible profit.

Dividends "Free of Income Tax."

Dividends to shareholders are usually paid subject to deduction of Income Tax at the standard rate in force for the year in which the dividend payable becomes due. In some cases, however, under the authority of the company's articles or a resolution of the company in general meeting, dividends are paid "free of tax," i.e., without tax being deducted. This phrase does not imply that no tax is payable on the dividends. Income Tax upon the profits of a company is invariably assessed upon the company and not upon the individual shareholders. Ordinarily, the company recovers the tax paid upon the distributed profits by deducting an appropriate amount from the dividend paid to each shareholder, but when a dividend is "free of tax," the gross amount of

the dividend is paid and the company bears the expense of the tax.

The effect of paying dividends in this manner is to increase the net sum received by the member of the company, and, as a general rule, " tax free " dividends are confined to the ordinary shareholders. If the preference shareholders were paid their fixed rate of dividend " tax-free " they would be receiving an increased dividend and the ordinary shareholders would suffer a corresponding loss. The same principle applies to debenture holders, who are entitled to receive only the fixed rate of interest, less income tax.

In order, however, to make their preference or debenture issues more attractive to investors, some companies pay the dividends or interest thereon " free of tax," but in such cases the articles or the resolution authorising the issue must specifically authorise the payment of dividends or interest in this manner. In other words, the general body of shareholders must consent to the extra payment.

The following is a simple formula to ascertain the gross amount of dividend payable—

$$\text{Net amount of dividend} \times \frac{20}{20-\text{rate of tax}} \text{ (in shillings).}$$

Arrears of Dividends.

When the dividends on a company's cumulative preference shares are in arrear, no entries are required to record this fact in the financial books. These dividends are payable only out of profits, and ordinarily no liability for payment can arise until sufficient profits are available for this purpose, and the dividend has been recommended by the directors and declared by the company in general meeting. Nevertheless there is a contingent liability, and the fact that the dividend is in arrear should be stated as a footnote to the Balance Sheet.

Payment of Dividends.

Dividends can be paid only after the payment has been sanctioned, generally by a resolution of the shareholders in accordance with the articles. It is usual for a company to confer express powers upon the directors to pay interim dividends on ordinary shares and interim and final dividends on preference shares without the sanction of the shareholders. The directors usually resolve, in addition, that the transfer books shall be closed for a stated period, in order that the dividend list may be prepared without being complicated by transfers made immediately prior to the distribution of the dividend. The resolution must be advertised.

In making such a payment, the company prepares a " Dividend

List," in which are shown in appropriate columns for each shareholder—

(*a*) The number of shares held;
(*b*) The amount paid-up on the shares held;
(*c*) The amount of the dividend at the appropriate rate;
(*d*) The amount of tax deductible therefrom;
(*e*) The net amount payable.

Dividend warrants will then be prepared in accordance with the list and posted to the shareholders. These warrants must, even if the dividend is declared "free of tax," disclose the gross amount before deduction of income tax, the rate and the amount of income tax appropriate to such gross amount, and the net amount actually paid.

The following draft ruling would be suitable for such a list:—

Dividend of 5% for the Year ended ....

On 500,000 Ordinary Shares of £1 each, fully paid: DECLARED ....

Share ledger folio.	Div. Warrant No.	Name.	Address for dividend.	No. of shares held.	Amount of dividend.	Tax.	Net amount payable.	Date paid.	Remarks.
					£ s. d.	£ s. d.	£ s. d.		

The entries required in the company's financial books are indicated by the following *pro forma* journal entries:—

DIVIDEND PAID LESS TAX.

		Dr. £ s. d.	Cr £ s. d
19..	Profit and Loss Appropriation Account *Dr.* To Dividend Account . . . . *Being dividend at .... % on ..... Ordinary Shares of £1 each, declared by shareholders at the Annual General Meeting held on ...., 19...*		
	Dividend Account . . . . *Dr.* To Income Tax Account . . . . *Being amount of income tax deductible from the above dividend.*		
	Dividend Account . . . . *Dr.* To Bank Account . . . . . *Being payment of the above dividend.*		

DIVIDEND PAID "FREE OF TAX."

	Dr. £ s. d.	Cr. £ s. d.
Profit and Loss Appropriation Account . . . *Dr.* To Dividend Account . . . *Being dividend at .... % free of tax on .... Ordinary Shares of £1 each declared by shareholders at the Annual General Meeting held on ...., 19...*		
Dividend Account . . . *Dr.* To Bank . . . . . . *Being payment of the above dividend.*		

The above is the method most frequently used in practice in the case of a "free of tax" dividend, though it would not be incorrect to "gross up" the dividend, the entries then being similar to those required for a dividend paid less tax.

The company's bankers will be instructed to transfer the total amount of the net dividend to a separate "Dividend Account," and the balance on this Dividend Account, as shown by the periodical examination of the special bank pass book, will represent the total dividends unpaid at any given date. Unclaimed dividends must be shown in the Balance Sheet as a liability until the expiration of the stipulated period within which they may be claimed, i.e., twenty years, unless the Articles provide otherwise. After this period the unclaimed dividends revert to the company, and should be transferred to Reserve Account. The balance of the Dividend Account will be included in the assets as part of the item "Cash at Bank," or it may be detailed as "Cash at Bank on Dividend Account."

Payments of debenture interest are recorded in a similar manner to payments of dividends.

Alterations of Capital.

Under the authority of Section 50 of the Act, a company may where its articles contain suitable provisions, alter its memorandum of association so as to

(*a*) Increase its share capital;

(*b*) Consolidate or divide its existing shares;

(*c*) Convert paid-up share capital into stock and reconvert stock into shares;

(*d*) Divide shares into smaller amounts provided that, where the shares are partly paid, the subdivision

is proportional as to the paid and unpaid amounts on each share ; and

(e) Cancel shares not taken up.

The power conferred upon a company to alter its capital must be exercised by the company by ordinary resolution in general meeting, unless the articles require some other form of resolution.

Where the nominal capital is increased, no entries are required in the financial books until a new issue of shares takes place, when the procedure outlined in Chapter VIII. for issues of capital must be adopted. Similarly, where shares not taken up are cancelled the financial books are not affected, the only entries required being in the company's minute books, in which particulars of the resolutions passed will be recorded.

For the consolidation or division of capital, the old capital accounts must be closed and new accounts opened in their place, a transfer entry being passed through the journal in the following manner :—

			Dr. £ s. d.	*Cr.* £ s. d.
19..	Preference Shares (£5) Account *Dr.*		50,000 0 0	
	To Preference Shares (£1) Account . . .			50,000 0 0
	Being the conversion of 10,000 5% *Preference Shares of* £5 *each into* 50,000 *Preference Shares of* £1 *each in accordance with Resolution dated* .... 19.. (*Vide Minute Book.*)			

A Share Conversion List, a specimen of which is shown on page 354 will be prepared, showing particulars of the old share capital held by each member and the new shares issued.

In addition, the old Register of Members will be closed and a new one opened, in which will be recorded particulars of the new shares issued in exchange.

Conversion of share capital into stock is dealt with in the same manner, the Share Capital Account being debited and the Stock Account credited with the amount converted. A Stock Conversion List should be compiled to record the necessary details, while the respective members' accounts in the share ledger will be closed, new accounts being opened in the stock ledger.

SHARE CONVERSION LIST.

Old Share Led. Fo.	Name.	Address and Occupation.	£5 Shares.				New £1 Shares.				New Share Led. Fo.	Remarks.
			Old Cert. No.	No. of Shares.	Distinctive Nos.		New Cert. No.	No. of Shares.	Distinctive Nos.			
					From	To			From	To		

Occasionally, companies give debenture holders the option of converting their debentures into shares, and the records in the company's books will appear in a similar manner to that outlined above.

Notice of any alteration made in the "capital" clause of the memorandum must be given, in the prescribed form, to the Registrar of Companies.

Reduction of Capital.

Where losses occur to a sole trader or to a partnership the amount of the loss must be made good by the trader or by the partners; alternatively, the loss may be debited to their capital account or accounts, resulting in a corresponding reduction thereof.

In the case of a limited company, however, the liability of the proprietors (i.e., of the shareholders) is limited to the nominal amount of their shares, and except in so far as such nominal amount is not paid up, there can be no question of the loss being "made good" by them. Moreover, as the capital cannot be varied to meet fluctuations in profits, the loss must be separately shown on the assets side of the Balance Sheet until it is eliminated by subsequent profits or sanction is obtained for the reduction of the company's capital.

The procedure to be adopted when a reduction of capital is proposed is outlined in Sections 55 to 60 of the Act and may be summarised in the following manner:—

(1) A scheme showing the amounts to be written off the company's capital (distinguishing the amount to be written off shares of different classes), and the manner in which the reduction is to be applied to

the various assets is prepared and submitted to the shareholders, who must approve the scheme by means of a special resolution.

(2) After the special resolution has been passed, a petition is made to the Court for sanction of the scheme.

(3) If satisfied that all creditors entitled to object to the reduction have either consented or been paid or secured, the Court may make an order confirming the reduction on such terms as it thinks fit, e.g., it may order that, for a specified period of time, the company must add the words " and reduced " to its title, or it may require the company to publish the reasons for reduction and the causes which led to the reduction with a view to giving proper information to the public.

(4) After sanction by the Court, a copy of the order, with particulars of the reduction and accompanied by copies of the special resolution as passed and confirmed by the shareholders, must be filed with the Registrar.

(5) The old share certificates must be called in from the shareholders and indorsed with particulars of the reduction, or alternatively, the old certificates must be cancelled and new ones issued.

(6) Particulars of the reduction should be indorsed on each member's account in the Share Ledger. (This may conveniently be done by means of a rubber stamp.)

The rights of the different classes of shareholders among themselves must be considered in determining the amount to be written off each class of share. Thus, if the preference shares have a right, in the event of a winding-up, to the return of capital in priority to the ordinary shares, then the whole or the major portion of the loss is frequently borne by the holders of the ordinary and the deferred shares (if any). In practice, however, any scheme which does not appear to bear too hardly on any particular class or classes of shareholders will receive the sanction of the Court.

If, in any question, you are asked to suggest a scheme for the reduction of capital, from the facts contained in a given Balance Sheet, make your answer as *practical* as possible. Study carefully the schemes published in the financial columns of the daily papers and introduce as many of the points given there as are pertinent to the question. Where, as in most cases, it is equitable that the ordinary shares shall bear the loss, they should never be entirely eliminated, though they may have to be reduced to a very small nominal value (e.g., 1d. or 1s.). By this means the ordinary shareholders retain some interest in the business and can thus reap some benefit from a subsequent boom period. Where part of the loss is borne by the preference shareholders,

it is usual to compensate them by increasing their dividend rights or by the allotment of ordinary shares (as reduced in value) to them, thus enabling the preference shareholders to participate in any surplus profits. Otherwise the ordinary shareholders retain the whole of the "equity" of the company (i.e., the right to receive surplus profit) and do not suffer any loss at all *under the scheme*, for the reduction of the nominal value of their shares merely gives effect to losses *which have already taken place*, and does not make the position of the ordinary shareholders any worse than it was before the reduction took place.

The method of treatment in the financial books is to credit a Capital Reduction Account with the total amount of the reduction, the capital account of each class of share affected being debited with the portion of the reduction relative thereto; while the debit balance of the Profit and Loss Account and any amounts written off assets are debited to the Capital Reduction Account, the respective asset accounts being credited.

The following example will illustrate the necessary entries:—

EXAMPLE.

The Balance Sheet of the A. B. C. Co., Ltd. shows the following position:—

BALANCE SHEET AS AT..........19..

Liabilities.	£	£	*Assets.*	£
Nominal Capital:—			Freehold Premises at cost	4,500
20,000 5% Preference Shares of £1 each	20,000		Plant and Machinery at cost	4,500
20,000 Ordinary Shares of £1 each	20,000		Stock-in-Trade	9,400
		40,000	Sundry Debtors	3,600
Issued Capital:—			Cash at Bank	4,000
10,000 5% Preference Shares £1 each, fully paid	10,000		Cash in hand	375
15,000 Ordinary Shares £1 each, fully paid	15,000		Profit and Loss Account	5,025
		25,000		
Sundry Creditors		6,400		
		£31,400		£31,400

The Preference Shares are preferential as to return of capital on Winding-up. Resolutions are passed and sanctioned by the Court:—

"That the Preference and Ordinary Shares be reduced by 2s. 6d. per share and 10s. per share respectively, to be applied as follows:—

Profit and Loss Account	£5,025
Freehold Premises	500
Plant and Machinery	1,250
Stock-in-Trade	1,975"

Make the entries necessary to give effect to the above, and prepare the new Balance Sheet.

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		Dr. £	Cr. £
19..	Sundries . . . . *Dr.*		
	To Capital Reduction Account . . .		8,750
	Preference Share Capital Account . . .	1,250	
	Ordinary Share Capital Account . .	7,500	
	Being reduction of 2s. 6d. per share on 10,000 5% Preference shares of £1 each and 10s. per share on 15,000 Ordinary shares of £1 each in accordance with special resolution passed at an extraordinary general meeting held on .... and sanctioned by order of the Court dated .... 19....		
	Capital Reduction Account . . . . *Dr.*	8,750	
	To Profit and Loss Account . . .		5,025
	„ Freehold Premises Account . .		500
	„ Plant and Machinery Account . .		1,250
	„ Stock-in-Trade		1,975
	Being amounts written off in accordance with scheme sanctioned by order of the Court dated.......... 19....		

Dr. CAPITAL REDUCTION ACCOUNT. *Cr.*

19..			£	19..			£
	To Profit and Loss Account .		5,025		By Pref. Share Capital .		1,250
	„ Freehold Premises .		500		„ Ord. Share Capital .		7,500
	„ Plant and Machinery .		1,250				
	„ Stock-in-Trade		1,975				
			£8,750				£8,750

Dr. 5% PREFERENCE SHARES. *Cr.*

19..			£	19..			£
	To Capital Reduction . .		1,250		By Balance		10,000
	„ Balance . .	c/d.	8,750				
			£10,000				£10,000
					By Balance	b/d.	8,750

Dr. ORDINARY SHARES. *Cr.*

19..			£	19..			£
	To Capital Reduction . .		7,500		By Balance .		15,000
	„ Balance . .	c/d.	7,500				
			£15,000				£15,000
					By Balance .	b/d.	7,500

A.B.C. COMPANY, LIMITED.

ADJUSTED BALANCE SHEET AS AT..........19..

Liabilities.	£	£
NOMINAL CAPITAL :—		
20,000 5% Preference shares of £1 each, reduced, by order of the Court to 17s. 6d. each . . .	17,500	
20,000 Ordinary shares of £1 each, reduced, by order of the Court to 10s. each . .	10,000	
		27,500
ISSUED CAPITAL :—		£
10,000 5% Preference shares, reduced, by order of the Court to 17s. 3d. each . .	8,750	
15,000 Ordinary shares, reduced, by order of the Court to 10s. each . . .	7,500	
		16,250
Sundry Creditors . .		6,400
		£22,650

Assets.	£	£
Freehold Premises at cost	4,500	
Less Amount written off	500	
		4,000
Plant and Machinery at cost . . .	£ 4,500	
Less Amount written off	1,250	
		3,250
Stock-in-Trade . .	£ 9,400	
Less Amount written off	1,975	
		7,425
Sundry Debtors . . .		3,600
Cash at Bank . . .		4,000
Cash in hand		375
Profit and Loss Account .	£ 5,025	
Less Amount written off	5,025	
		£22,650

NOTE.—The Court may order the company to add the words " and reduced " to its name for a specified period.

Where a company's capital is in excess of its requirements it may either with or without extinguishing or reducing liability on any of its shares, pay off any excess or unemployed share capital (Section 55).

In this case Share Capital Account is debited with the amount returned to the shareholders and Cash Account credited, the necessary alterations being made in the Share Register. It is also usual in this case to transfer an equivalent amount from Profit and Loss Appropriation Account to Capital Reserve Account, in order to conserve the working capital.

Amalgamation and Absorption of Companies.

It is nowadays a common practice for concerns engaged in the same trade to agree to combine, or, as it is technically termed, to amalgamate, with the object of, *inter alia*, eliminating, or at all events decreasing the risk of competition, pooling financial, technical and commercial resources, and securing the economies attending large-scale production (e.g., more advantageous buying of raw materials). Such amalgamations take different forms according to circumstances and according to the terms agreed

upon between the companies concerned; the principal forms being :—

(1) The old companies agree to sell their ASSETS TO A NEW COMPANY promoted by them, and the old companies are wound up. The liquidators of the old companies become the vendors, receiving from the new company fully paid shares and/or cash for distribution to the old shareholders. This method is usually referred to as an *amalgamation*.

(2) The old companies retain their separate existence, one company (either a new company or some other existing company) acquiring the SHARES of the other companies. In this case, what really occurs is a change of shareholders; the purchasing company (or its nominees) becoming a shareholder in the other companies. This is the *holding company* type of amalgamation, which will be dealt with more fully later in this chapter (see pages 386 to 398).

(3) An existing company acquires the ASSETS of the other company (or companies) in consideration of the issue of fully paid shares and/or a cash payment. This method is usually referred to as an *absorption*.

AMALGAMATION—ENTRIES IN OLD COMPANIES' BOOKS.—Taking into consideration the difference in the nature of the proprietorship, the entries required to close the books of the old companies are on similar lines to those required to close the books of a partnership (see "Partnership Dissolution Accounts" in Chapter XV), and may be summarised as follows :—

(1) Open a REALISATION ACCOUNT and debit it with the book value of the assets taken over by the purchasing company, the corresponding asset accounts being credited. As a rule, cash is not taken over, and will therefore remain as a balance on Cash Account. Fictitious assets, such as Preliminary Expenses or a debit balance on Profit and Loss Account, will not be taken over by the purchasing company, but will be dealt with as indicated in (7) below.

(2) Credit Realisation Account with the liabilities taken over by the purchasing company, and debit the corresponding liabilities accounts.

(3) Credit Realisation Account and debit an account in the name of the purchasing company with the amount of the purchase consideration.

(4) Credit the purchasing company's account with the amount paid in satisfaction of the purchase consideration, and debit Shares in Purchasing Company

Account and/or Cash Account, according to whether the purchase consideration is discharged in shares and/or cash.

(5) Debit Realisation Account and credit Cash with the expenses of realisation (where the purchasing company has not agreed to defray them.)

(6) Transfer Share Capital Account, credit balance on Profit and Loss Account, and any other undistributed profits (e.g., General Reserve) to Sundry Shareholders' Account.

(7) Credit any fictitious asset accounts (e.g., Preliminary Expenses, debit balance on Profit and Loss Account) and debit Sundry Shareholders' Account.

(8) Close off Realisation Account, which will then disclose either a profit (credit balance) or a loss (debit balance) on realisation. In the former case, debit Realisation Account and credit Sundry Shareholders' Account; in the latter case credit Realisation Account and debit Sundry Shareholders' Account.

(9) Close off Sundry Shareholders' Account by debiting it with the shares in the purchasing company and cash distributed to the shareholders, and credit Shares in Purchasing Company Account and Cash Account.

Where there are two or more classes of shares in the selling company, a separate Sundry Shareholders' Account would, in practice, be opened in respect of each class of share, but for examination purposes it is permissible to use a single Sundry Shareholders' Account.

AMALGAMATION—ENTRIES IN PURCHASING COMPANY'S BOOKS.—These are substantially the same as those required upon the formation of a limited company to acquire the business of a sole trader or a partnership (see Example on pages 297 to 303). The values at which the assets and liabilities taken over stood in the books of the vendor company are not necessarily applicable to the purchasing company, which may bring them into its books at amended valuations, the old values being ignored.

It will usually be found that the purchase consideration is either more or less than the book values (amended, where necessary) of the net assets (i.e., assets *less* liabilities) taken over. The balancing entry in the purchasing company's books will be :—

(*a*) If the purchase consideration is greater than the book value of the net assets, debit the difference to GOODWILL ACCOUNT.

(*b*) If the purchase consideration is less than the book value of the net assets, credit the difference to CAPITAL RESERVE ACCOUNT.

Similar entries will be made in respect of each company which is taken over by the new (purchasing) company. If the latter also makes an issue of shares to the public, the book entries will be on the lines indicated on pages 285 and 286.

The Act gives power to a company to acquire compulsorily the shares of shareholders dissenting from a scheme of amalgamation on the same terms as those offered to approving shareholders (subject to the order of the Court), provided that, *inter alia*, the scheme has been approved by the holders of not less than nine-tenths in value of the shares or class of shares affected. (Section 155).

EXAMPLE.

The Balance Sheets at 31st December, 19.., of Exe, Ltd., and Wye, Ltd., two companies carrying on a similar trade, were :—

EXE, LTD.—BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital (Authorised and Issued)	50,000	Sundry Assets . . .	90,000
Sundry Liabilities . .	20,000		
General Reserve . . .	5,000		
Profit and Loss Account .	15,000		
	£90,000		£90,000

WYE, LTD.—BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital (Authorised and Issued)	40,000	Sundry Assets . . .	38,000
Sundry Liabilities . .	10,000	Profit and Loss Account .	12,000
	£50,000		£50,000

As from the above date, they agreed to amalgamate, and a new company, Exewye, Ltd., was formed to take over the assets and liabilities of both companies, on the basis of the values shown in the above Balance Sheets, for the following considerations :—

Exe, Ltd.—75,000 shares of £1 each and £5,000 in cash.
Wye, Ltd.—20,000 shares of £1 each and £5,000 in cash.

Exewye, Ltd., also made a public issue, which was fully subscribed and paid for, of £50,000 shares of £1 each.

Show the Journal entries necessary to close the books of Exe, Ltd., and Wye, Ltd., and to open the books of Exewye, Ltd., and draw up a Balance Sheet of Exewye, Ltd., after giving effect to the above transactions. State how much the various shareholders in the old companies would receive. Ignore realisation expenses.

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EXE, LTD.—JOURNAL.

	£	£
Realisation Account . . . . . *Dr.*	90,000	
To Sundry Assets		90,000
Being sundry assets taken over by Exewye, Ltd., as per agreement dated.......		
Sundry Liabilities . . . . . *Dr.*	20,000	
To Realisation Account		20,000
Being sundry liabilities taken over by Exewye, Ltd., as per agreement dated.......		
Exewye, Ltd. . . . . . . *Dr.*	80,000	
To Realisation Account		80,000
Being agreed purchase consideration.		
Shares in Exewye, Ltd. . . . *Dr.*	75,000	
Cash . . . . „	5,000	
To Exewye, Ltd.		80,000
Being discharge of purchase consideration.		
Share Capital Account . . . *Dr.*	50,000	
General Reserve . . . . . „	5,000	
Profit and Loss Account . . . . „	15,000	
To Sundry Shareholders		70,000
Being transfer of balances.		
Realisation Account . . . . . *Dr.*	10,000	
To Sundry Shareholders		10,000
Being profit on realisation.		
Sundry Shareholders . . . . *Dr.*	80,000	
To Shares in Exewye, Ltd.		75,000
„ Cash		5,000
Being purchase consideration received by shareholders.		

WYE, LTD.—JOURNAL.

	£	£
Realisation Account . . . . . *Dr.*	38,000	
To Sundry Assets		38,000
Being sundry assets taken over, etc.....		
Sundry Liabilities . . . . . *Dr.*	10,000	
To Realisation Account		10,000
Being sundry liabilities taken over, etc....		
Exewye, Ltd. . . . . . . *Dr.*	25,000	
To Realisation Account		25,000
Being agreed purchase consideration.		

WYE, LTD.—JOURNAL—*continued.*

	£	£
Shares in Exewye, Ltd. . . . . *Dr.*	20,000	
Cash . . . . „	5,000	
To Exewye, Ltd.		25,000
Being discharge of purchase consideration.		
Share Capital Account . . . . *Dr.*	40,000	
To Profit and Loss Account . . .		12,000
„ Sundry Shareholders . . .		28,000
Being transfer of balances.		
Sundry Shareholders . . . . *Dr.*	3,000	
To Realisation Account		3,000
Being loss on realisation.		
Sundry Shareholders . . . . *Dr.*	25,000	
To Shares in Exewye, Ltd. . . .		20,000
„ Cash		5,000
Being purchase consideration received by shareholders.		

EXEWYE, LTD.—JOURNAL.

	£	£
Sundry Assets . . . . . . *Dr.*	90,000	
Goodwill . . . . „	10,000	
To Sundry Liabilities		20,000
„ Liquidator of Exe, Ltd. (Vendor) .		80,000
Being assets and liabilities taken over from Exe, Ltd., and purchase consideration, as per agreement dated.....		
Liquidator of Exe, Ltd. (Vendor) . *Dr.*	80,000	
To Share Capital Account . . .		75,000
„ Cash		5,000
Being discharge of purchase consideration.		
Sundry Assets . . . . . . *Dr.*	38,000	
To Sundry Liabilities		10,000
„ Capital Reserve [see Note (1)] . .		3,000
„ Liquidator of Wye, Ltd. (Vendor) .		25,000
Being assets and liabilities taken over, etc.....		
Liquidator of Wye, Ltd. (Vendor) . *Dr.*	25,000	
To Share Capital Account . . .		20,000
„ Cash		5,000
Being discharge of purchase consideration.		
Application, Allotment and Call Accounts *Dr.*	50,000	
To Share Capital Account . . .		50,000
Being issue of shares to the public.		

EXEWYE, LTD.—JOURNAL—*continued.*

		£	£
Cash . . . . *Dr.*		50,000	
To Application, Allotment and Call Accounts			50,000
Being receipt of moneys for above issue.			

EXEWYE, LTD.—Balance Sheet as at ....

Liabilities.	£	*Assets.*	£
Share Capital :—		Goodwill	10,000
Authorised	?	Sundry Assets . . .	128,000
Issued—145,000 Shares of £1 each, fully paid .	145,000	Cash	40,000
Sundry Liabilities . .	30,000		
Capital Reserve . . .	3,000		
	£178,000		£178,000

Shareholders in Exe, Ltd., will receive 3 shares in Exewye, Ltd., for every 2 held in Exe, Ltd., and 2s. in cash for every share in Exe, Ltd.

Shareholders in Wye, Ltd., will receive 1 share in Exewye, Ltd., for every 2 held in Wye, Ltd., and 2s. 6d. in cash for every share in Wye, Ltd.

Notes :—

(1) The Capital Reserve of £3,000 arising out of the purchase of the business of Wye, Ltd., may be used, if desired, to write down the book value of any of the assets taken over from that company, if they are considered to be over-valued. Alternatively, the amount of such Capital Reserve can be used in the reduction of the item Goodwill in connection with the net assets acquired from Exe, Ltd. This latter method is recommended in that it is generally contended that the items Capital Reserve and Goodwill should not both appear in the same Balance Sheet.

(2) The reason why such items as General Reserve and Profit and Loss Account balance are not taken over by the new company must be thoroughly understood. Assuming that there are no fictitious assets in a company's Balance Sheet, its net assets must necessarily be equivalent to the shareholders' "equity" in the concern (i.e., Share Capital *plus* any undistributed profits); thus, in the case of Exe, Ltd., the net assets of £70,000 are equal in amount to the shareholders' "equity" (Share Capital, £50,000 *plus* General Reserve, £5,000 *plus* Profit and Loss Account, £15,000). Clearly, therefore, a company cannot purchase *both* net assets *and* the "proprietorship" accounts which show how such assets are represented on the liabilities side of the Balance Sheet.

Where a reserve on the liabilities side of the Balance Sheet represents a *diminution in the value of certain items on the assets side* (e.g., a Reserve for Depreciation), the position is different; the reserve must then be deducted from the relative gross assets before arriving at the book values of the assets to be taken over by the purchasing company.

Absorption.—The book-keeping entries arising out of an absorption, both in the books of the purchasing company and in those of the vendor company (or companies) are very similar to those already explained in the case of an amalgamation. The main difference is that in the case of an absorption the purchasing

company is already in existence, and is very likely already carrying on business of a nature similar to that carried on by the absorbed company. Any assets taken over which are of a similar type to assets already appearing in the purchasing company's books will therefore be debited to existing asset accounts, and future Balance Sheets of the purchasing company will usually show its assets without any distinction between those originally held and those acquired from the absorbed company.

EXAMPLE.

Condensors, Limited, entered into arrangements to sell their undertaking to Radio Components, Limited.

The Balance Sheet of Condensors, Limited, was as follows :—

Liabilities.	£	*Assets.*	£
Nominal Capital—		Goodwill at cost . . .	2,000
20,000 6% Preference Shares of £1 each . . .	20,000	Patent Rights at cost . .	5,000
30,000 Ordinary Shares of £1 each	30,000	Machinery and Plant at cost *less* depreciation . .	14,000
	£50,000	Stock-in-Trade . .	5,000
Subscribed Capital—		Sundry Debtors . . .	3,000
10,000 6% Preference Shares of £1 each, fully paid .	10,000	Profit and Loss Account .	25,000
30,000 Ordinary Shares of £1 each, fully paid . .	30,000		
Loans	5,000		
Sundry Creditors . . .	8,500		
Bank Overdraft . . .	500		
	£54,000		£54,000

The current Balance Sheet of Radio Components, Limited, is as follows :—

Liabilities.	£	*Assets.*	£
Nominal Capital—		Freehold Property at cost .	10,000
50,000 7% Preference Shares of £1 each . . .	50,000	Patent Rights at cost *less* depreciation . . .	15,000
40,000 Ordinary Shares of £1 each	40,000	Machinery and Plant at cost *less* depreciation . .	20,000
	£90,000	Stock-in-Trade . . .	25,000
Subscribed Capital—		Sundry Debtors . . .	25,000
35,000 7% Preference Shares of £1 each, fully paid .	35,000	Cash at Bank . . .	15,000
25,000 Ordinary Shares of £1 each, fully paid . .	25,000		
Sundry Creditors . . .	15,000		
General Reserve . . .	25,000		
Profit and Loss Account .	10,000		
	£110,000		£110,000

The terms of sale were :—

Radio Components, Limited, to take over all assets of Condensors, Limited, together with the liabilities.

Radio Components, Limited, to pay the cost of liquidation of Condensors, Limited.

Loanholders in Condensors, Limited, to receive 5% Mortgage Debentures in Radio Components, Limited, to the full extent of their holdings.

Preference Shareholders in Condensors, Limited, to receive three 7% Preference Shares in Radio Components, Limited, of £1 each, for each four shares held by them.

Ordinary Shareholders in Condensors, Limited, to receive one Ordinary Share in Radio Components, Limited, of £1 each, for each five shares held by them.

The above-mentioned arrangements were duly carried out, the cost of winding up Condensors, Limited, amounting to £600.

Show the Journal entries necessary to incorporate the figures in the books of Radio Components, Limited, and set out the Balance Sheet of that company after the absorption has taken place.

RADIO COMPONENTS, LIMITED.—JOURNAL.

		£	£
	Sundries . . . *Dr.*		
	To Sundries		
	Goodwill [see Note (2)] . . .	500	
	Patent Rights	5,000	
	Machinery and Plant	14,000	
	Stock-in-Trade	5,000	
	Sundry Debtors	3,000	
	Sundry Creditors . . .		8,500
	Bank Overdraft		500
	Condensors, Limited . . .		18,500
	Being assets and liabilities taken over from Condensors, Limited, as per agreement dated..........		
	Condensors, Limited . . . . *Dr.*	18,500	
	To Sundries		
	Preference Share Capital Account .		7,500
	Ordinary Share Capital Account . .		6,000
	5% Mortgage Debentures Account .		5,000
	Being discharge of purchase consideration for assets and liabilities taken over from Condensors, Limited, as per agreement and minute dated..........		
	Absorption Expenses (*per* Liquidator of Condensors, Ltd.) . . . . *Dr.*	600	
	To Cash		600
	Being payment of cost of winding-up Condensors, Ltd.		

RADIO COMPONENTS, LTD.—BALANCE SHEET AS AT ....

Liabilities.	£	*Assets.*	£
Nominal Capital—		Goodwill at cost	500
50,000 7% Preference Shares of £1 each . . .	50,000	Freehold Property at cost .	10,000
40,000 Ordinary Shares of £1 each	40,000	Patent Rights at cost *less* depreciation	20,000
	£90,000	Machinery and Plant at cost *less* depreciation . . .	34,000
		Stock-in-Trade . . .	30,000
Subscribed Capital—		Sundry Debtors . . .	28,000
42,500 7% Preference Shares of £1 each, fully paid .	42,500	Cash at Bank . . .	14,400
31,000 Ordinary Shares of £1 each, fully paid . .	31,000	Absorption Expenses . .	600
5% Mortgage Debentures . .	5,000		
Sundry Creditors . . .	23,500		
Bank Overdraft . . .	500		
General Reserve . . .	25,000		
Profit and Loss Account . .	10,000		
	£137,500		£137,500

NOTES :—

(1) Absorption Expenses, £600 should preferably be written off to Profit and Loss Account in the near future. Alternatively, however, the item may be added to Goodwill Account.

(2) Alternatively, the Goodwill appearing in Condensors, Ltd.'s Balance Sheet could have been brought into the books of Radio Components, Ltd. This would, however, merely have resulted in the creation of a Capital Reserve of £1,500, which would have then been available for writing down Goodwill to the figure brought in in the above solution (£500).

(3) It is assumed that, with the exception of Goodwill, Radio Components, Ltd. does not revalue any of the assets and liabilities taken over. Any revaluation would bring about a corresponding adjustment in the book value of Goodwill, since this represents the "balancing item."

(4) In working the above example it has been assumed that the debentures were issued to the liquidator of Condensors, Ltd., for distribution to the loanholders. If, however, Radio Components, Ltd., formally took over the loans and made the distribution of the debentures direct to the loanholders, the purchase consideration would be £13,500 only, and in the books of Condensors, Ltd., Loans Account would be debited and Realisation Account credited with the loans taken over.

The entries in the Journal of Radio Components, Ltd., would be :—

	£	£
Sundry Assets . . . . . . *Dr.*	27,500	
To Sundry Creditors		8,500
„ Bank Overdraft		500
„ Loans		5,000
„ Condensors, Ltd.		13,500
Being assets and liabilities taken over from Condensors, Ltd.		
Condensors, Ltd. . . . . . *Dr.*	13,500	
To Preference Share Capital . . .		7,500
„ Ordinary Share Capital		6,000
Being discharge of purchase consideration.		

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	£	£
Loans Account . . . . *Dr.*	5,000	
To Sundry Loanholders		5,000
Being transfer of loans to be cancelled.		
Sundry Loanholders . . . . *Dr.*	5,000	
To Mortgage Debentures . . .		5,000
Being issue of debentures to sundry loanholders.		
Absorption Expenses . . . *Dr.*	600	
To Cash		600
Being payment of cost of winding-up Condensors, Ltd.		

When the shares of the purchasing company are quoted at a premium on the market, this fact should be taken into account in computing the number of shares to be allotted to the absorbed company in full or part satisfaction of the purchase consideration. Thus, if the purchase consideration, to be satisfied entirely in fully paid £1 Ordinary shares, is £30,000, and these shares are standing at 24s., it would not be correct to allot 30,000 shares, for the shareholders would thereby obtain assets which could be realised for £36,000. The correct procedure is to compute the number of shares which, at the current market value, would equal the amount of the purchase consideration, and to credit Share Capital Account accordingly, the balance being credited to a Premium on Shares Account. The necessary Journal entry would be :—

	£	£
Vendor Company's Account . . *Dr.*	30,000	
To Ordinary Share Capital Account .		25,000
„ Premium on Shares Account . .		5,000
Being discharge of purchase consideration.		

The balance on Premium on Shares Account may, if desired, be utilised in writing down any Goodwill arising out of the absorption.

Reconstruction of Companies.

The term " reconstruction " cannot be exactly defined, for it is used in a very wide sense to express any material alteration in the constitution of a company or in the rights or interests of shareholders, debenture holders or other creditors. A company reconstruction frequently, though not necessarily, involves the winding-up of an existing company and the transfer of its assets to a new company. An amalgamation scheme *may* also involve a reconstruction.

Reconstructions may be found necessary for a number of reasons. A company may be burdened with an accumulation of losses which it is desirable to clear off in order to place the company in a favourable position for the earning of profits; it may be desirable to raise further capital from existing shareholders by forming a new company and allotting to them partly-paid shares therein; the company may wish to extend the scope of its Memorandum; and so on.

The following points are of importance in drafting a reconstruction scheme:—

(1) The avoidance of overcapitalisation, especially in respect of goodwill.

(2) The maintenance of adequate liquid capital. For this purpose a further issue of shares by the new or reconstructed company may be necessary if external liabilities of the old company are to be discharged.

(3) The preservation of the equities of the shareholders. This will depend upon the reasons for the reconstruction. Any accumulated losses will seriously affect the equity of the ordinary shareholders in cases where preference shares are preferential as to capital. In other cases the relative equities of ordinary and preference shareholders as they existed in the old company should be maintained in the new company, except in so far as any secret reserves are adjusted for the benefit of one class of shareholders only.

(4) Debentures must be satisfied either by repayment or by exchange for a new issue of debentures at a lower rate of interest with a capital compensation, or partly for debentures and partly for shares.

(5) Creditors must be dealt with according to their demands, and the procedure of the liquidator in this respect is largely controlled by the provisions of Section 153 of the Companies Act.

EXAMPLE.

The following is the Balance Sheet of a limited company:—

Liabilities.	£	*Assets.*	£
Share Capital (Authorised and Issued):—		Goodwill at cost	30,000
200,000 7½% Preference Shares of £1 each, fully paid .	200,000	Patents and Trade Marks at cost *less* depreciation . .	10,000
100,000 Ordinary Shares of £1 each, fully paid . .	100,000	Property, Plant, etc., at cost *less* depreciation . . .	120,000
£10,000 6% Debentures . .	10,000	Stock-in-Trade	12,000
Bank Loan	3,000	Sundry Debtors	15,000
Sundry Creditors . . .	12,600	Cash at Bank	4,000
		Profit and Loss Account . .	134,600
	£325,600		£325,600

The directors are desirous of reconstructing the company to avoid the burden of interest charges, and to apportion the losses equitably over the various classes of persons concerned.

If consulted by the directors, to what points would you pay particular attention in formulating a scheme ?

Particular attention would be paid to the following points in drafting a scheme for the reconstruction of the company :—

(1) The desirability or otherwise of winding-up the existing company. If a new company was floated it would lose the benefit, from a taxation point of view, of the large accumulated losses. On the other hand a new company would probably be more favourably placed towards obtaining additional capital. The choice of method would obviously depend upon the actual facts, details of which are not given.

(2) The rights of the different classes of shareholders as determined in the Memorandum and Articles of Association, i.e.,

(*a*) Are there any arrears of Preference dividends ? (Preference dividends are cumulative unless the articles provide to the contrary).

(*b*) Are the Preference Shares preferential as to capital ? If so, the whole or the greater part of the loss should be borne by the Ordinary Shareholders.

The Articles may contain special provisions as to the rights of shareholders on a winding-up or reorganisation, although any such provision could be varied by a special resolution.

(3) The rights of the Debenture Holders and whether they are secured or unsecured. Before a scheme could finally be formulated it would be necessary to call a meeting of the debenture holders in order to ascertain their attitude towards a reconstruction, the amount of sacrifice (if any) they would be prepared to make, and the satisfaction which they would most readily accept for their debt.

(4) The same would apply to the Bank Loan although this would usually be secured and the Bank would not be prepared to make any sacrifice. It should be ascertained that the Bank would be willing to look to the new company or to the reconstructed company for repayment of the Loan. Otherwise the scheme would have to be framed with a view to replenishing the liquid resources of the company, depleted by repayment of the Bank Loan.

(5) Creditors—their general attitude towards the reconstruction and the composition they would be prepared to accept.

(6) Valuation of Assets—Goodwill is presumably of no value and the other assets should be revalued with a view to ascertaining the full amount of the loss of capital to be written off under the reorganisation.

(7) The state of the money and share market and the general trade outlook. This would determine whether an issue of capital in the form of shares or debentures would be likely to meet with any success and whether any such issue would be advisable from the point of view of possible future profits.

The reconstruction and amalgamation of companies have been facilitated by the exemption from stamp duties afforded by various Finance Acts. When a company is registered or an existing company has its share capital increased for the purpose of acquiring the undertaking of, or not less than 90 per cent. of the issued shares in, another company and the consideration

consists, as to at least 90 per cent. thereof, of shares in the purchasing company, then

(a) the sale agreement is exempt from *ad valorem* duty; and
(b) the new capital created for the purpose (with certain limitations) is exempt from capital duty.

The detailed provisions are complicated, but their general effect is to make possible reconstruction schemes involving exchanges of shares between two companies without payment of duty.

Bonus Shares.

Where companies have a large reserve fund, it is sometimes desired to bring the issued capital more into harmony with the actual net working capital as represented by the company's assets. To effect this, an issue of shares credited as fully paid is made to the existing shareholders, *pro rata* to their holdings. This will cause the profits to be spread over a larger number of shares, resulting in a lower rate of dividend being paid unless increased profits are made in the future. The company's articles must contain authority to distribute profits in the form of shares credited as fully paid, and the company must also pass a special resolution sanctioning the issue of the shares.

Entries will also require to be made in each member's account in the Share Ledger, and a " Return of Allotments " must be filed with the Registrar of Companies.

In general it may be stated that it is unwise to pay a dividend in the form of bonus shares, unless the company is in a position to pay a fair rate of dividend on the capital as increased by the bonus. Where capital is increased without any increase in earning capacity, a reduction in the rate of dividend must ultimately ensue, and when the reduction brings the rate of dividend below a fair commercial return in that class of business the capital is said to be " watered."

It may be added that bonus shares are sometimes issued in lieu of a cash dividend when a company desires to conserve its cash resources; and where additional cash is required they are occasionally issued credited as partly paid from reserve, the balance being payable by the shareholder in cash. They may also be issued at a premium thereby strengthening the financial position of the company by transferring to a *permanent* Capital Reserve an amount which might have been used, say, to pay a bonus in cash and would then be lost to the company; or where the issued shares are only partly paid-up a bonus may be declared and applied in paying up the uncalled capital.

The records in the company's financial books are sufficiently indicated by the examples given on the following pages.

EXAMPLES.

I. Issue of Fully-Paid Bonus Shares

The Alpha Company, Limited, had an issued and paid-up capital of 20,000 shares of £1 each, and a Reserve Account of £7,000. Part of the reserve was distributed among the shareholders by declaring a bonus of one fully paid share for every five shares held by the members. Show the journal entries recording the bonus

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		Dr. £	Cr. £
19..	Reserve Account . . . *Dr.*	4,000	
	To Bonus Account . . .		4,000
	Being transfer of amount required for the bonus payable in fully paid shares as per resolution dated...............19.....		
	Bonus Account . . . . . *Dr.*	4,000	
	To Share Capital Account . . .		4,000
	Being allotment and issue of 4,000 Shares of £1 each credited as fully paid, in satisfaction of bonus declared on ....19...., in the proportion of one share for every five shares held in this company.		

II. Issue of Partly-Paid Bonus Shares

Assuming the bonus shares in Example I. are issued as £1 shares paid up to the extent of 15s. 0d. per share and a call of 5s. 0d. per share is then made, show the journal entries recording such transactions.

JOURNAL

		Dr. £	Cr. £
19..	Reserve Account . . . . . *Dr.*	3,000	
	To Bonus Account		3,000
	Being transfer of amount required for the bonus payable in partly-paid shares as per resolution dated..........19..		
	Bonus Account . . . . . *Dr.*	3,000	
	To Share Capital Account . . .		3,000
	Being allotment and issue of 4,000 Shares of £1 each credited as 15s. 0d. paid up, in satisfaction of bonus declared on ....19.., in the proportion of one share for every five shares held in this company.		
	Call Account . . . . . . *Dr.*	1,000	
	To Share Capital Account . . .		1,000
	Being call of 5s. 0d. per share on 4,000 Shares.		
	Cash . . . . *Dr.*	1,000	
	To Call Account		1,000
	Being receipt of call money		

III. Bonus Applied in Satisfaction of Call.

The Beta Co., Ltd., declared a bonus of 25% on its issued Share Capital of 10,000 Shares of £1 each, 15s. 0d. paid up, such bonus to be applied in making the existing shares fully paid. Show the journal entries recording the bonus.

JOURNAL.

		Dr. £	Cr. £
19..	Reserve Account . . . . . Dr.	2,500	
	Bonus Account		2,500
	Being transfer of amount required for the bonus of 25% on issued Share Capital as per resolution dated........19..		
	Call Account . . . . Dr.	2,500	
	To Share Capital Account		2,500
	Being call of 5s. 0d. per share on 10,000 Shares of £1 each, 15s. 0d. paid up.		
	Bonus Account . . . . . Dr.	2,500	
	To Call Account		2,500
	Being application of bonus in satisfaction of call of 5s. 0d. per share on 10,000 Shares.		

IV. Issue of Bonus Shares at a Premium.

Assuming the bonus shares in Example I. are issued at a premium of 25% show the journal entries recording the bonus.

JOURNAL.

		Dr. £	Cr. £
19..	Reserve Account . . . . . Dr.	5,000	
	To Bonus Account		5,000
	Being transfer of amount required for the bonus payable in fully-paid shares at a premium of 5s. 0d. per share as per resolution dated..........19....		
	Bonus Account . . . . . Dr.	5,000	
	To Share Capital Account		4,000
	,, Premium on Shares Account . .		1,000
	Being allotment and issue of 4,000 Shares of £1 each credited as fully paid, at a premium of 5s. 0d. per share, in satisfaction of bonus declared on .... 19...., in the proportion of one share for every five shares held in this company.		

Where new shares are issued in place of preference shares redeemed, the Capital Redemption Reserve Fund may be applied, up to an amount equal to the nominal amount of the shares so

issued, in paying up unissued shares to be issued to the members as fully paid bonus shares (see page 274).

Watered Capital and Over-Capitalisation.

It has already been observed that the indiscriminate capitalisation of profits by issuing bonus shares is known as "watering" the capital, and the capital so issued, as "watered" capital. The foundation of a bonus issue is the earning of profits in excess of the average yield for that class of business, therefore, if bonus shares are issued to such an extent that it is impossible to pay a fair rate of dividend on the *increased* capital, the issue has served no useful purpose. In fact, such an issue will defeat all the advantages attached to bonus shares.

Where capital is watered discontent may be caused amongst the shareholders if their dividends are reduced, and the attractiveness of the shares as an investment will be impaired.

The example below illustrates the danger of the indiscriminate capitalisation of profits.

EXAMPLE.

Capital, £100,000: Annual Profits, £15,000; Fair Commercial yield, 10%.

The capital may be increased, i.e., by bonus shares, to £150,000 without reducing the rate of dividend below the fair commercial return. It would therefore be quite in order for the company to pay bonus dividends to the amount of £50,000 if profits were available.

If, however, the capital is increased to £200,000 the average profits are only sufficient to pay a dividend of 7½%, which is 2½% below the fair commercial yield. To the extent of £50,000, therefore, the capital is said to be watered.

Over-capitalisation is similar to the watering of capital in that it also is brought about by an issue of capital in excess of the true requirements as measured by the earning capacity of assets. Over-capitalisation usually arises from an erroneous estimate of financial requirements when a company is formed. Thus over-capitalisation will occur in the following circumstances :—

(1) On the purchase of a business by a limited company if a price is paid for goodwill which is not justified by profits ; or an inflated price is paid for fixed assets which have not been revalued in the light of current profit-earning capacity.

(2) On the formation of a limited company if the capitalisation is fixed without due regard to the scale of production and the amount of working capital required, so that the company finds itself with funds which it cannot use profitably.

When a company is over-capitalised it is hampered from the start by its inability to earn profits sufficient to yield a fair return on its capital.

On the other hand, if a company is capitalised on too low a scale it may find itself short of funds and consequently will be unable to operate at the most profitable scale of production

without resorting to borrowing. In this case, as with over-capitalisation, the profits will usually be too low to yield a satisfactory return on the capital subscribed.

Since it is far easier to increase the capital than to reduce it, it is better to err on the side of under-capitalisation than on that of over-capitalisation.

Scrip Dividends.

Unless the articles provide otherwise, members are entitled to receive their dividends in cash (*Wood* v. *Odessa Waterworks Co.*). Where, however, the articles so provide, a dividend may be paid "in specie," assets other than cash being transferred to the members in payment of dividends. This must not be confused with an issue of bonus shares, in which the company issues *its own shares* to members. In the case of a scrip dividend, the company transfers its *assets*, though these are frequently shares in another company held as investments. Such dividends will always be paid "free of tax," and profits must be available for dividend before a scrip dividend can be paid.

EXAMPLE.

A company has an issued capital of 10,000 Ordinary Shares of £1 each. Included in the company's investments are 5,000 shares of £1 each in A.B., Ltd., which were purchased at par. Having the necessary power in its articles, the company declares a scrip dividend, by which one share in A.B., Ltd., is to be distributed for every five Ordinary Shares held.

Show the Shares in A.B., Ltd. Account in the company's ledger.

Dr. SHARES IN A.B., LTD. *Cr.*

		Nominal.	*Capital.*			*Nominal.*	*Capital.*
		£	£			£	£
To Balance .	*b/d.*	5,000	5,000	By Dividend Account .		2,000	2,000
				,, Balance .	*c/d.*	3,000	3,000
		£5,000	£5,000			£5,000	£5,000
To Balance .	*b/d.*	3,000	3,000				

The Final Accounts and Balance Sheet.

The Trading and Profit and Loss Accounts of limited companies are compiled in a similar manner to those of partnerships, but the net profit of each year as shown by the Profit and Loss Account is not divided immediately between the owners of the business (i.e., the shareholders), but is transferred to the credit of a Profit and Loss Appropriation Account, against which are debited transfers to reserves, sinking fund instalments for the redemption of liabilities, contributions to staff pension funds, and dividends paid, etc. The balance is carried forward to the following year,

and the Appropriation Account is thus a continuous running account, which for convenience may be shown at the foot of the Profit and Loss Account as shown on page 382.

EXAMPLE.

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT. *Cr.*

(*For the Year ended* 31*st December*, 1941.)

1941			£	1941		£	£
Dec. 31	To Reserve		2,000	Jan. 1	By Balance *b/f*	12,586	
	„ Staff Pension Fund		630		*Less* Final Ord. Dividend (1940)	7,000	
	„ Interim Preference Dividend (1941)		2,500				5,586
	„ Final Preference Dividend (1941)		2,500	Dec. 31	„ Net Profit for the year from Profit and Loss Account		
	„ Interim Ordinary Dividend (1941)		3,000				10,150
	„ Balance	*c/d*	5,106				
			£15,736				£15,736

It is very rarely that public companies issue detailed Trading and Profit and Loss Accounts to their shareholders. To do so might mean disclosing valuable information to possible competitors, thereby leading to injury of the company's business. Most companies show merely the Profit and Loss Appropriation Account in the above or some similar form. It is a common practice to charge Debenture Interest and Directors' Fees in the Appropriation Account; strictly speaking, however, these items are *charges against* profits, not appropriations thereof, and, therefore, should be debited to the Profit and Loss Account.

Again, it must be remembered that the sanction of shareholders is required for the payment of dividends (subject to the exceptions referred to on page 344), and therefore the latter cannot be shown in the accounts until the resolution authorising the payment has been passed by the shareholders. The company's debt to the shareholders does not accrue until the dividend has been declared, consequently it is a general rule that neither recommended dividends nor arrears of preference dividends should be shown in the accounts and Balance Sheet.

In the case of dividends on preference shares, however, the articles of association sometimes confer authority upon the directors to declare and pay the fixed dividend as and when it falls due, provided there are sufficient profits. In such cases, this dividend may, of course, be included in the Profit and Loss Appropriation Account and shown as a liability in the Balance Sheet if unpaid at the date thereof.

Debenture interest, on the other hand, must be paid whether profits are earned or not, and accrued interest which is due but

unpaid must, therefore, be reserved for in the final accounts and shown as a liability in the Balance Sheet.

The Act provides that a Profit and Loss Account must be laid before the company in general meeting, at a date not later than eighteen months after the incorporation of the company, and subsequently once at least in every calendar year. The account must be made up to a date which is not more than nine months prior to the date of the meeting. The Act does not state, however, what information must be given in the required Profit and Loss Account, except that the aggregate amount of directors' fees must be disclosed, the term "fees" being exclusive of any remuneration of a managing director or payments to other directors by way of salary.

Disclosure in Published Accounts.

The question of the form and contents of the published Balance Sheets of limited companies was seriously considered by the Company Law Amendment Committee prior to the passing of the Companies Act, 1929, with the result that the following entirely new and important provisions were incorporated in this Act to improve the hitherto unsatisfactory state of affairs by which Balance Sheets were drawn up in a thoroughly uninformative manner.

It should be noted that these provisions do not apply to all companies but only those incorporated under the Companies Acts. For example, these provisions do not apply to companies incorporated by Royal Charter or to parliamentary companies subject to the Companies Clauses Consolidation Act, 1845.

Every Balance Sheet of a company must contain a summary of the authorised and issued share capital of the company, its liabilities and its assets, together with such particulars as are necessary to disclose the general nature of the liabilities and assets and to distinguish between the amounts of the fixed and floating assets, and must state how the values of the fixed assets have been arrived at [Section 124 (1)].

The following items must be stated under separate headings so far as they have not been written off :—

(*a*) The preliminary expenses of the company ; and

(*b*) Any expenses incurred in connection with any issue of share capital or debentures ; and

(*c*) The amount of the goodwill, and of any patents and trade marks, so far as it is ascertainable from the books of the company, or from any contracts or other documents in the possession of the company [Similar 124 (2)].

Where any liability is secured otherwise than by operation of law on any assets of the company, the Balance Sheet must include a statement that that liability is so secured, but it is not necessary to specify the assets on which the liability is secured [Section 124 (3)].

Where a company has power to re-issue debentures which have been redeemed, particulars of such debentures must be included in the Balance Sheet (Section 75).

Any Redeemable Preference Shares which have been issued must be clearly indicated in the Balance Sheet, together with the date on or before which such shares are or are to be liable to be redeemed (Section 46).

Particulars of any discount allowed on the issue of shares and not written off must be disclosed in the Balance Sheet (Section 47).

Particulars of loans to directors must be disclosed in the accounts, in the manner laid down in Section 128 (see page 276).

Unfortunately, some of the foregoing provisions are rather ambiguous and consequently difficult of interpretation. This is evidenced by a comparison of the balance sheets of companies published since the provisions became operative. In some cases it has obviously been the intention to disclose as little as possible, while, on the other hand, more information has been given in many cases than is deemed necessary, in order to comply with the provisions of the Act, possibly to be on the "safe side."

For example, in distinguishing between fixed and floating assets it is not necessary to group the assets under separate headings, although this course is to be commended. Occasionally difficulty may be experienced in determining under which class an asset falls, e.g., investments, and in all such doubtful cases the basis of the valuation should be given and the assets regarded as fixed.

Further difficulty arises in complying with the provision calling for the basis of valuation of fixed assets to be stated. The following statement, for instance, while complying with the strict letter of the Act, gives little or no information as to the adequacy or otherwise of the depreciation provisions :—

	£
Plant and Machinery at cost, *less* depreciation	70,000

On the other hand the following would give more detailed information :—

	£	
Plant and Machinery at cost .	100,000	
Less Depreciation . .	30,000	
		£70,000

It is considered in many quarters that it would be more satisfactory if the law demanded a statement of the history of the fixed assets, including disclosure of the amount or rate of depreciation; for example :—

		£	£
Plant and Machinery—purchase price at.... 19..		20,000	
Add Expenditure since :—	£		
Amount as per last Balance Sheet	25,000		
Year to date	2,000		
		27,000	
		47,000	
Less depreciation written off :—			
Amount as per last Balance Sheet	14,000		
During the year to date	3,000		
		17,000	
			30,000

Sòme companies have already adopted the above method, or one substantially similar to it, but it should be understood that this goes beyond bare legal requirements.

Accounts published since the provisions of the Act came into operation show a diversity of opinion as to whether Section 124 (2) calls for the disclosure of goodwill, patents and trade marks in one item, or whether goodwill should be shown as a distinct item from patents and trade marks. It is thought, however, that goodwill may be included as one item with patents and trade marks, provided that the basis of valuation adopted by the company is the same in each case. Otherwise, it is advisable that these items should appear under separate headings, e.g., "Goodwill, at cost, £100,000," and "Patents and Trade Marks, at cost, less amounts written off, £5,000."

To every published Balance Sheet of a company there must be attached a directors' report showing :—

(*a*) The state of the company's affairs ;
(*b*) The amount (if any) which they recommend should be paid by way of dividend ; and
(*c*) The amount (if any) which they propose to carry to the reserve fund, general reserve or reserve account shown specifically on the Balance Sheet, or to be shown on a subsequent Balance Sheet [Section 123].

Every Balance Sheet must be signed by two directors (or, if there is only one director, by that director), and the auditors' report must be attached thereto (Section 129).

A *pro-forma* balance sheet, showing the requirements of the Act as to disclosure, is set out in Appendix I. at the end of Chapter XIX.

EXAMPLES OF FINAL ACCOUNTS

Two examples of typical examination exercises are given below. Students are recommended to trace each item through the final accounts to the Balance Sheet, noting carefully how the adjustments are made. It will be observed that in one question there are numerous adjustments to be made at the end of the trading period, while in the other question the principal adjustments are in connection with the vendor's accounts. Explanatory notes are given on doubtful points.

EXAMPLE I

The Walturdaw Engineering Company, Limited, was registered with a nominal capital of £100,000, divided into 50,000 Ordinary Shares of £1 each, and 50,000 7% Redeemable Preference Shares of £1 each which were to be redeemed on or before 30th June, 19.... The whole of the Preference Shares were issued and fully subscribed and paid up. 20,000 of the Ordinary Shares were issued as fully paid in payment for the goodwill of the established business taken over by the company. The balance of the Ordinary Shares were offered to the public and fully subscribed. 15s. per share had been called and paid up, with the exception of the second call of 5s. per share on 1,000 shares, which remained unpaid as on 31st December, 19... 200 6% Mortgage Debentures of £100 each had been issued at 105 and were fully paid up. 10 of these Debentures were redeemed in December and were capable of being re-issued.

In addition to the accounts necessary to record the above transactions, the following ledger balances were extracted from the books of the company as on 31st December, 19.. :—

	£
Machinery and Plant at cost	15,840
Preliminary Expenses Account	573
Manufacturing Wages	37,841
Purchases	189,742
Do. Returns	1,124
Sales	260,836
Do. Returns	924
Staff Pension Fund	9,500
Investments (Staff Pension Fund) at cost	9,495
Advertising	3,750
Factory Fuel and Lighting	2,862
Machinery Repairs	741
Salaries of Factory Managers	2,300
Do. Office Staff	3,261
Debenture Interest	1,200
Motor Lorries at cost	2,800
Petrol and Running Expenses of Lorries	376
Transfer Fees	8
Factory Expenses	1,384
Bonus to Factory Workpeople	2,000
Do. Office Staff	500
Office Expenses	472
Office Furniture at cost	600
Directors' Fees	1,000
Discount Account (Credit Balance)	127

	£
Stock (1st January, 19..)	32,986
Sundry Debtors	22,940
Sundry Creditors	21,784
Bad Debts	724
Audit Fee	125
Freehold Factory and Office at cost	38,500
Cash at Bank	8,990
Cash in hand	986
Apprentices' Premiums received	650
National Health Insurance (Factory)	378
Travellers' Salaries and Commission	2,989

You are required to prepare Trading and Profit and Loss Accounts for the year ended 31st December, 19.., and a Balance Sheet as on that date.

When preparing these accounts the following matters are to be taken into consideration :—

(*a*) Depreciation is to be provided for as follows :—Machinery and Plant, 10%, Motor Lorries, 15%, Office Furniture, 5%.

(*b*) Wages for one week, £738, and Salaries for one month, £275, were due as on 31st December, 19.., and had not been passed through the books.

(*c*) The Vendors were liable for one-third of the Preliminary Expenses, and it was decided to write off to Profit and Loss Account the Company's share of these expenses.

(*d*) A Reserve for Bad Debts is to be created amounting to £1,400.

(*e*) The Stock on hand, as on 31st December, 19.., was valued at £46,942.

(*f*) On 28th December, 19.., a claim was received for £250 for non-delivery of goods in the time specified under a contract. The claim was admitted, but no entries had been made in the books.

(*g*) A contribution of £600 is to be made from profits to the Staff Pension Fund.

(*h*) £5,000 is to be carried to a Reserve Account.

(*i*) £250 of the apprentices' premiums is to be carried forward to next year.

(*j*) Provision is to be made in the accounts for the dividend due on the Preference Shares for the year ended 31st December, 19....

(*k*) The Sundry Creditors include a loan of £1,000 secured by a charge on the Company's freehold property.

(*l*) The Sundry Debtors include an amount of £500, being the balance of a loan of £2,500 made to a director in July, £2,000 having been repaid in December.

THE WALTURDAW ENGINEERING COMPANY, LIMITED

TRADING AND PROFIT AND LOSS ACCOUNTS.

Dr. FOR THE YEAR ENDING 31ST DECEMBER, 19... *Cr.*

	£	£		£	£
To Stock at 1st Jan., 19...		32,986	By Sales	260,836	
„ Purchases	189,742		*Less* Returns	924	
Less Returns	1,124				259,912
		188,618	„ Stock at 31st Dec., 19..		46,942
„ Manufacturing wages		38,579			
„ Fuel and lighting		2,862			
„ Bonus		2,000			
„ Machinery repairs		741			
„ Salaries (Factory managers)		2,300			
„ Factory expenses		1,384			
„ National health insurance		378			
„ Depreciation of Plant and Machinery		1,584			
„ Gross profit carried down		35,422			
		£306,854			£306,854

	£	£		£
To Salaries		3,536	By Gross profit brought down	35,422
„ Advertising		3,750	„ Transfer fees	8
„ Debenture interest		1,200	„ Discounts	127
„ Motor expenses		376	„ Apprentices' premiums	400
„ Bonus		500		
„ Office expenses		472		
„ Directors' fees		1,000		
„ Bad debts		2,124		
„ Claim on contract		250		
„ Audit fee		125		
„ Travellers' salaries and commission		2,989		
„ Depreciation :—	£			
Motor lorries	420			
Office furniture	30			
		450		
„ Balance, being Net Profit carried down		19,185		
		£35,957		£35,957

	£		£
To Preliminary Expenses	382	By Balance brought down	19,185
„ Reserve Account	5,000		
„ Staff Pension Fund	600		
„ Preference Dividend	3,500		
„ Balance carried forward	9,703		
	£19,185		£19,185

NOTE.—The salaries due but unpaid (£275) are assumed to relate to the office staff and not the factory managers.

Where bonuses are payable to employees under a profit-sharing scheme, the amounts should be shown in the Appropriation Account, but it is assumed that the bonuses charged herein are "additions" to wages and salaries, not dependent upon the amount of profits earned. Amounts written off preliminary expenses are usually deemed to be appropriations of profits.

THE WALTURDAW ENGINEERING COMPANY, LIMITED

BALANCE SHEET.

AS AT 31ST DECEMBER, 19...

Liabilities.		£
NOMINAL CAPITAL :—		
50,000 Ordinary Shares of £1 each		50,000
50,000 7% Redeemable Preference Shares of £1 each—to be redeemed on or before 30th June 19...		50,000
		£100,000
ISSUED CAPITAL :—		
20,000 Ordinary Shares of £1 each, fully paid		20,000
30,000 Ordinary Shares of £1 each, 15/- called	£ 22,500	
Less Calls in arrear	250	
		22,250
		42,250
50,000 7% Redeemable Preference Shares of £1 each, fully paid		50,000
		92,250
200 6% Mortgage Debentures of £100 each	£ 20,000	
Less Redeemed and capable of being re-issued	1,000	
		19,000
Reserve Account		5,000
Debenture Premium Account		1,000
Staff Pension Fund	9,500	
Transferred from Profit and Loss Account	600	
		10,100
Sundry Creditors :—		
Trade	20,784	
Secured	1,000	
Claim Outstanding	250	
Apprentices' premiums paid in advance	250	
Wages and salaries outstanding	1,013	
Preference Dividend	3,500	
		26,797
Profit and Loss Account		9,703
		£163,850

Assets.		£
Goodwill at cost		20,000
FIXED ASSETS :—		
Freehold Factory and Office at cost		38,500
Machinery and Plant at cost	£ 15,840	
Less Depreciation	1,584	
		14,256
Motor Lorries at cost	2,800	
Less Depreciation	420	
		2,380
Office Furniture at cost	600	
Less Depreciation	30	
		570
Investments (Staff Pension Fund) at cost		9,495
FLOATING ASSETS :—		
Stock		46,942
Sundry Debtors :—		
Trade	22,440	
Less Reserve for Bad Debts	1,400	
	21,040	
Vendors for Preliminary Expenses	191	
		21,231
Loan to Director	2,500	
Less Repaid	2,000	
		500
Cash at Bank		8,990
Do. in hand		986
		£163,850

EXAMPLE II.

A, *B*, and *C* decided to convert their business into a limited company with a nominal capital of £100,000, divided into 50,000 6% Preference Shares of £1 each, and 50,000 Ordinary Shares of £1 each.

The firm's Balance Sheet at 31st December, 1940, is as follows :—

Liabilities.		£	*Assets.*	£
Creditors		20,000	Property	20,000
Bank		5,500	Plant and Machinery	10,000
Capital :—	£		Stock	25,000
A	25,000		Book Debts	30,000
B	20,000		Cash in hand	500
C	15,000			
		60,000		
		£85,500		£85,500

The profits for the three years ended 31st December, 1940, were £5,000, £7,000 and £8,000 respectively. The following arrangements were agreed:—(1) To create goodwill equal to the aggregate of the last three years' profits; (2) To credit the goodwill to the partners in proportion to their capitals; (3) To transfer to the company the plant and machinery, property and stock only; (4) The book debts to be collected by the new company on behalf of the vendors who were responsible for discharging all the liabilities of the firm; (5) The cash in hand was taken over by the company, the latter being required to account for it to the vendors; (6) *A* and *B* to take 5,000 6% Preference Shares each and the balance of their capital in Ordinary Shares, *C* to take the whole of his capital in 6% Preference Shares.

The preliminary expenses, amounting to £1,000, were borne by the company and were to be written off over a period of three years if profits allowed. The following figures were extracted from the firm's books for the purpose of making up interim accounts at 30th June, 1941:—

	£		£
Purchases	40,000	Sales	59,200
Wages	5,000	Discount Received	800
Carriage Inwards	1,000	Creditors	12,000
Discount Allowed	1,100		
Repairs	250		
Rates and Insurance	350		
Coal for Power	500		
General Expenses	1,500		
Preliminary Expenses	1,000		
Salaries	2,000		
Bank	250		
Cash	50		
Debtors	24,000		

The Stock at 30th June, 1941, amounted to £22,000.

The Debtors at 30th June, 1941, included £4,000 belonging to the vendors, £1,000 of which was irrecoverable, and should be written off. All the liabilities of the old firm had been discharged. Discounts allowed and received included £500 and £200 respectively in connection with the vendors' debts.

Draw up Trading and Profit and Loss Accounts and Balance Sheet at 30th June, 1941, allowing 2½% discount off the company's debtors and 1¼% off creditors. Allow 5% depreciation on plant and machinery.

Dr. VENDORS' PURCHASE ACCOUNT. *Cr.*

1941			£	1941			£
Jan.	1	To *A*—Preference Shares	5,000	Jan. 1	By Goodwill		20,000
"	1	" " Ordinary Shares	26,250	" 1	" Property		20,000
"	1	" *B*—Preference Shares	5,000	" 1	" Plant and Machinery		10,000
"	1	" " Ordinary Shares	20,000	" 1	" Stock		25,000
"	1	" *C*—Preference Shares	18,750				
			£75,000				£75,000

NOTE.—The purchase price is divisible in the proportions of 5, 4 and 3 to *A*, *B* and *C*., i.e., in proportion to their former capitals of £25,000, £20,000 and £15,000 respectively; *A*, therefore, receives £31,250, *B* £25,000 and *C* £18,750.

Dr. VENDORS' ACCOUNT. *Cr.*

1941			£	1941			£
Jan. 1	To Partnership Liabilities taken over .		25,500	Jan. 1	By Partnership Debts taken over .		30,000
June 30	„ Bad Debts . .		1,000	„ 1	„ Cash taken over .		500
„ 30	„ Discounts allowed .		500	June 30	„ Discounts received		200
„ 30	„ Balance . .	c/d.	3,700				
			£30,700				£30,700
				June 30	By Balance . .	b/d.	3,700

A, B AND C, LTD.

TRADING AND PROFIT AND LOSS ACCOUNTS.

Dr. For the Half-Year ended 30th June, 1941. *Cr.*

	£				£		
To Opening Stock	25,000	0	0	By Sales . .	59,200	0	0
„ Purchases .	40,000	0	0	„ Closing Stock .	22,000	0	0
„ Carriage Inwards .	1,000	0	0				
„ Wages . .	5,000	0	0				
„ Coal . .	500	0	0				
„ Gross Profit to Profit and Loss Account	9,700	0	0				
	£81,200	0	0		£81,200	0	0
To Salaries . .	2,000	0	0	By Gross Profit from Trading Account .	9,700	0	0
„ Rates and Insurance .	350	0	0	„ Discounts Received .	750	0	0
„ General Expenses .	1,500	0	0				
„ Discounts Allowed .	1,100	0	0				
„ Repairs . .	250	0	0				
„ Depreciation of Plant and Machinery .	500	0	0				
„ Net Profit to Appropriation Account	4,750	0	0				
	£10,450	0	0		£10,450	0	0
To Preliminary Expenses .	166	13	4	By Net Profit from Profit and Loss Account .	4,750	0	0
„ Balance available for distribution .	4,583	6	8				
	£4,750	0	0		£4,750	0	0

The item "Discounts Allowed, £1,100" is arrived at as follows:—

	£
Balance on Discount Account.	1,100
Less Vendors' Account	500
	600
Add Reserve for Discount, $2\frac{1}{2}$% on £20,000 . .	500
Discount *debited* to Profit and Loss Account . .	£1,100

The item "Discounts Received, £750" is arrived at as follows:—

	£
Balance on Discount Account.	800
Less Vendors' Account	200
	600
Add Reserve for Discount, $1\frac{1}{4}$% on £12,000 . .	150
Discount *credited* to Profit and Loss Account . .	£750

A, B AND C, LTD.

BALANCE SHEET.

AS AT 30TH JUNE, 1941.

Liabilities.

	£	s.	d.	£	s.	d.
NOMINAL CAPITAL:—						
50,000 6% Pref. Shares of £1 each . .	50,000	0	0			
50,000 Ord. Shares of £1 each . .	50,000	0	0			
				£100,000	0	0
ISSUED CAPITAL:—						
28,750 6% Pref. Shares of £1 each, fully paid	28,750	0	0			
46,250 Ord. Shares of £1 each, fully paid	46,250	0	0			
				75,000	0	0
Sundry Creditors . .	12,000	0	0			
Less Reserve for Discounts . .	150	0	0			
				11,850	0	0
A, *B* and *C* (Vendors)				3,700	0	0
Profit and Loss Account Balance .				4,583	6	8
				£95,133	6	8

Assets.

	£	s.	d.	£	s.	d.
Goodwill at cost . .				20,000	0	0
FIXED ASSETS—						
Property at cost .				20,000	0	0
Plant and Machinery at cost	10,000	0	0			
Less Depreciation 5%	500	0	0			
				9,500	0	0
FLOATING ASSETS—						
Stock . . .				22,000	0	0
Debtors . . .	20,000	0	0			
Less Reserve for Discounts. .	500	0	0			
				19,500	0	0
Debtors of *A*, *B* and *C*				3,000	0	0
Cash at Bank . .	250	0	0			
Cash in hand . .	50	0	0			
				300	0	0
Preliminary Expenses .	1,000	0	0			
Less written off .	166	13	4			
				833	6	8
				£95,133	6	8

Holding Companies' Accounts.

The growth and expansion of the activities of modern commerce have given rise to the development of the particular type of company known as the "holding company." The term "holding company" has a wide significance and may comprise the true holding or "parent" company, owning a working majority of the ordinary shares issued by a number of subsidiary companies, or it may be taken as representing the ordinary trust or investment company, which merely owns a majority holding of the shares of other companies as an investment. Thus, in the case of the true Holding Company, its object is to obtain control of the various companies whose shares it holds, while the main object of the investment company is the holding of investments for the purpose of earning revenue. The former type of company is that which it is proposed to consider at this stage.

The Companies Act, 1929, provides that where the assets of a company consist in whole or in part of shares in another company, whether held directly or through a nominee, and the first company holds more than fifty per cent. of the issued share capital of the second company, or possesses more than fifty per cent. of the voting power in the second company, or has power, directly or indirectly, to appoint the majority of the directors in the second company, this latter company is deemed to be a subsidiary company. This provision thereby furnishes a legal definition of a subsidiary company and (indirectly) of a holding company (Section 127).

A company may own a substantial holding of shares in another company but if none of the conditions set out above brings the latter within the definition of a subsidiary company the term affiliated (or associated) company should be used.

The development of the holding company may be attributed to the modern desire of business men for consolidation and amalgamation without the disturbing elements of liquidation. The formation of a holding company is the most effective way in which the amalgamation of the interests of several subsidiary companies may be secured without unnecessary interference with the existing organisation of such companies.

The usual procedure adopted is for a new company to be formed with the object of acquiring upon a predetermined basis of valuation the shares of several existing companies, in exchange for shares in the holding company. Future profits of the several undertakings are paid by way of dividend to the holding company, which, in turn, distributes them amongst its shareholders, thereby giving each individual member of any of the old companies an interest in the profits of all the companies involved in the amalgamation.

In practice, it is usually found necessary to reorganise the pre-existing boards of directors of both the holding company and the various subsidiary companies, a change which is usually effected by each subsidiary company having a representative on the directorate of the holding company; this reorganised board of directors controls the policy of the whole of the consolidated undertaking. The boards of the subsidiary companies will also require reorganisation by the election of nominees of the holding company to the various boards, thus making the subsidiary companies integral parts of the organisation of the holding company, and yet retaining the legal fiction of separate entity. It should be noted, however, that this arrangement is not common to all holding companies; the method of reorganisation adopted depends on the circumstances of each particular case.

Holding companies may be divided into two well-defined classes—those which, in addition to holding the controlling interest in and directing the affairs of other companies, are themselves actively engaged in a trade or business; and those of a

non-trading nature whose only source of income is the dividend funds of its subsidiary companies.

In addition to the provisions of the Act set out on page 377, which are equally applicable to holding companies, the Act further provides that the Balance Sheet of a holding company must disclose, under separate headings, the following items :—

(*a*) The aggregate amount of shares held in subsidiary companies ;
(*b*) The aggregate amount of debts due from subsidiary companies ;
(*c*) The aggregate amount of debts due to subsidiary companies (Section 125).

A statement, signed by the directors who sign the Balance Sheet, must also be annexed to the Balance Sheet of a holding company showing how the aggregate profits and losses of the subsidiary companies have been dealt with in the accounts of the holding company, and in particular to what extent provision has been made for losses of subsidiary companies in the accounts of those companies or of the holding company, or both, and to what extent losses of subsidiary companies have been taken into account in arriving at the profits and losses of the holding company (Section 126).

Should the auditor's report on the Balance Sheet of a subsidiary company be qualified, particulars of such qualification must be included in the aforementioned statement.

An example of such a statement is as follows :—

"The profit of the company for the year ended 31st December, 19.., includes the profits of subsidiary companies which have made profits, only to the extent that dividends have actually been declared by such companies, less the aggregate amount of this company's share of the losses of those subsidiary companies which have sustained losses.

"In the case of one company, the auditors have qualified their report in respect of the Balance Sheet at 31st December, 19.., as to the realisability of a debt due amounting to £.. and included in Sundry Debtors."

The entries necessary to record, in the books of the holding company, the acquisition of shares in a subsidiary company, are (i) a debit to Shares in Subsidiary Company Account, and (ii) a credit to either Cash or Share Capital Account, according to whether the shares were acquired for cash or for shares in the holding company.

When dividends are received from subsidiary companies, the normal entry is a debit to Cash and a credit to Dividends from Subsidiary Companies Account, the balance on which will be transferred at the end of the financial period to Profit and Loss Account. But this general rule requires modifying where a dividend is declared *out of profits made prior to the date of acquisition of the shares by the holding company* ; for where a subsidiary

company, at the date of acquisition of its shares by the holding company, possesses undistributed profits, this fact will normally be reflected in the price paid for the shares. Any dividend received by the holding company out of such profits should therefore be looked upon as a part return of the purchase price of the shares, and should be credited to Shares in Subsidiary Company Account.

The Final Accounts of Holding Companies.

The form of presentation of the final accounts of holding companies is a matter of considerable controversy, but it may here be stated that the four main methods adopted are as follows :—

(1) To publish the Balance Sheet and Profit and Loss Account of the holding company, showing the interest in subsidiary companies as an investment (at or below cost) in the Balance Sheet of the holding company. The current market value (if any) of the shares held should be noted on the Balance Sheet. The profits of the holding company include the dividends actually received from the subsidiary companies.

This first method, which is referred to as the "legal" Balance Sheet method, is compulsory the remaining methods merely consisting of a legal Balance Sheet supplemented by additional information.

(2) To publish the accounts of the holding company in detail as in (1), accompanied by separate schedules showing the Balance Sheets and Profit and Loss Accounts of each of the subsidiary companies.

(3) To publish the accounts of the holding company in detail as in (1), together with a separate schedule summarising the combined assets and liabilities of all the subsidiary undertakings. In the event of there being outside shareholders in any of the subsidiary companies, their respective interests should be shown as liabilities.

(4) To publish the accounts of the holding company in detail as in (1), together with a consolidated Balance Sheet of the whole undertaking amalgamating the assets and liabilities of all the subsidiary companies with those of the holding company, and a consolidated Profit and Loss Account including the profits and losses of all the companies. If the holding company does not own the whole of the capital of the subsidiary companies, the consolidated Balance

Sheet should show as a liability the total interests of all outside shareholders, including preference shareholders.

Consolidated Balance Sheets.

The object of a Consolidated Balance Sheet is to exhibit in a single statement a bird's-eye view of the state of the financial affairs of a group of associated companies.

The several companies comprising a group are separate entities, each keeping its own set of books and compiling its own final accounts, but as a consolidated balance sheet, like the balance sheet of a single company, must set out the position at a particular time, the separate subsidiary balance sheets from which the consolidated statement is prepared, must all be drawn up as at the same date, or adjustments made in order that the exact position on the date of the consolidated balance sheet may be ascertained. Similarly, it is advisable that the balance sheets of all companies in the group should be drawn up on a uniform basis as regards classification of assets and liabilities.

In the case of a holding company which owns all the shares of a subsidiary company, the assets and liabilities of the latter belong in effect (though not in strict law) entirely to the holding company, and a consolidated balance sheet can be prepared by combining the relative items in the balance sheets of the holding and subsidiary companies. In effect, the item "Shares in Subsidiary Company," which appears in the holding company's legal balance sheet, is replaced in the consolidated balance sheet by the assets and liabilities (including undistributed profits) which the holding company owns by reason of this shareholding. The consolidated balance sheet thus ignores the separate legal entities of the two companies and shows the position of the group as a whole.

Any inter-company balances (e.g., debts owing by a subsidiary company to the holding company, or *vice versa*) must be eliminated in preparing the consolidated balance sheet. Thus if, at the date of the balance sheet, a subsidiary company owes £1,000 to the holding company, this debt will appear as an asset in the holding company's balance sheet and as a liability in the subsidiary company's balance sheet. But when a consolidated balance sheet is prepared, the item, which is an asset of one member of the group, is neutralised by a corresponding liability of another member, and both asset and liability must be eliminated.

Similarly, where the holding company sells goods to the subsidiary, or *vice versa*, any profit added by the selling company must be eliminated from stock-in-hand in the consolidated balance sheet. From the point of view of the companies as separate legal entities it is perfectly correct to show stock at cost (unless this is above current market value), but from the

point of view of the group as a whole, such a procedure would be equivalent to taking credit for a profit before it had been earned by resale of the goods to a person outside the group of companies.

EXAMPLE.

From the following Balance Sheets of Traders, Ltd., and its two subsidiaries, Traders (Southern Counties), Ltd., and Traders (Midlands), Ltd., drawn up as at 31st December 19.., prepare a Consolidated Balance Sheet to show the position of the group of companies as a whole. The stock-in-hand of Traders (Southern Counties), Ltd., includes £500 stock purchased from Traders, Ltd., upon which the latter company has taken credit for £100 profit. At the date of acquisition of the shares by Traders, Ltd., there was no balance on the Profit and Loss Account of either of the two subsidiaries (the reason for this statement will be better understood when you have read the remarks on page 393).

TRADERS, LTD.

Balance Sheet as at 31st December 19..

Liabilities.			*Assets.*		
		£			£
Share Capital Authorised and Issued—			Freehold Property, at cost		10,000
20,000 Shares of £1 each		20,000	Plant and Machinery, at cost, *less* depreciation		2,250
Sundry Creditors—	£		Investments in Subsidiary Companies, at cost—	£	
General	4,000		Traders (S.C.), Ltd., 5,000 shares of £1 each	5,000	
Traders (S.C.), Ltd.	500		Traders (M.), Ltd., 2,500 shares of £1 each	2,500	
		4,500			7,500
Profit and Loss Account		4,000	Stock, at cost		5,250
			Sundry Debtors—		
			General	2,500	
			Traders (M.), Ltd.	250	
					2,750
			Cash		750
		£28,500			£28,500

TRADERS (SOUTHERN COUNTIES), LTD.

Balance Sheet as at 31st December 19..

Liabilities.			*Assets.*		
		£			£
Share Capital, Authorised and Issued—			Plant and Machinery, at cost, *less* depreciation		3,000
5,000 Shares of £1 each		5,000	Stock, at cost		2,500
Sundry Creditors—	£		Sundry Debtors—	£	
General	800		General	1,000	
Traders (M.), Ltd.	200		Traders, Ltd.	500	
		1,000			1,500
Profit and Loss Account		1,500	Cash		500
		£7,500			£7,500

TRADERS (MIDLANDS), LTD.

BALANCE SHEET AS AT 31ST DECEMBER 19..

Liabilities.		£	*Assets.*		£
Share Capital, Authorised and Issued—			Plant and Machinery at cost, *less* depreciation		1,500
2,500 Shares of £1 each		2,500	Stock, at cost		700
Sundry Creditors—	£		Sundry Debtors—	£	
General	500		General	700	
Traders, Ltd.	250		Traders (S.C.), Ltd.	200	
		750			900
			Cash		100
			Profit and Loss Account		50
		£3,250			£3,250

CONSOLIDATED BALANCE SHEET.

AS AT 31ST DECEMBER 19..

Liabilities.		£	*Assets.*	£
Share Capital, Authorised and Issued—			Freehold Property, at cost	10,000
20,000 Shares of £1 each		20,000	Plant and Machinery, at cost, *less* depreciation—	
Sundry Creditors—			[£2,250+£3,000+£1,500]	6,750
[£4,000+£800+£500]		5,300	Stock, at cost—	
Profit and Loss Account—	£		[£5,250+£2,500+£700−£100]	8,350
Traders, Ltd.	4,000		Sundry Debtors—	
Less profit on unsold stock	100		[£2,500+£1,000+£700]	4,200
	3,900		Cash—	
Traders (S.C.), Ltd.	1,500		[£750+£500+£100]	1,350
	5,400			
Less Traders (M.), Ltd.— Loss	50			
		5,350		
		£30,650		£30,650

In the above example it is assumed that the shares in the subsidiary companies have been acquired at par. When, however, a holding company acquires the shares of a subsidiary company at a premium or at a discount, certain adjustments become necessary when preparing the consolidated balance sheet.

If the shares are acquired at a premium, the sum paid therefor by the holding company will exceed the nominal value of the shares acquired, which represents the excess of assets over liabilities and undistributed profits in the subsidiary company's

balance sheet. Consequently, when these assets and liabilities are substituted for the investment in the subsidiary company in the consolidated balance sheet, there will be a difference which represents the excess of the purchase price paid over the nominal value of the shares acquired. This difference represents an undisclosed asset which must be brought into the consolidated balance sheet as "Goodwill," or "Excess of cost of shares in subsidiary over their nominal value," in addition to any Goodwill which may already appear in the balance sheets of the holding company and/or the subsidiary company.

Where shares in a subsidiary company are acquired at a discount, the cost of such shares is less than the value of the holding, based upon the net assets appearing in the books of the subsidiary company. The difference in this case must be shown as a Capital Reserve on the liabilities side of the consolidated balance sheet.

Where shares in one or more subsidiary companies are acquired at a premium and others at a discount the net difference in the purchase prices will appear in the consolidated balance sheet as Goodwill or Capital Reserve, as the case may be.

Minority or Outside Shareholders.

Up to this point it has been assumed that the holding company acquires the whole of the issued share capital of the subsidiary company, but in practice this is not always the case. The holding company may acquire only sufficient shares to give it a majority of the voting powers or to enable it to appoint the majority of the directors of the subsidiary company, and in such cases the shareholders owning the minority of the shares are usually referred to as Minority or Outside Shareholders. In many cases the preference shareholders are also included in this term, for, where the preference shares only carry voting rights when the dividend is in arrear, the holding company may not have acquired any, as a holding of preference shares is not usually essential for control purposes.

Since the consolidated balance sheet is drawn up to show the position of the group as a whole, it is evident that, where there are minority or outside shareholders in the subsidiary company, it is incorrect to bring in the whole of the assets and liabilities of the subsidiary without any further amendment. For example, if the capital of a company consists of 1,000 shares of the same class, then each share gives the holder the right to a one-thousandth part of the net assets of the company, in other words, to a one-thousandth part of the share capital plus any undistributed profits. Consequently, where the holding company holds, say, 800 shares, the share of the net assets belonging to the

outside shareholders (the owners of the remaining 200 shares) must be taken into consideration when preparing the consolidated balance sheet. This may be done by including :—

(*a*) Only such proportion of each asset and liability as is attributable to the holding company (four-fifths, in the above example) ; *or*

(*b*) The whole of the assets and liabilities, with the value of the outside shareholders' interest shown as a separate item on the liabilities side.

The latter is the simpler method, and is generally to be recommended for examination purposes.

Pre-acquisition Profits.

Where a holding company acquires some or all of the shares of a subsidiary company which, at the date of purchase, has a credit balance on Profit and Loss Account and/or a General Reserve of undistributed profits, the price paid for the shares will include the holding company's share of such balances. Consequently, as indicated on page 388, any dividend received by the holding company out of such pre-acquisition profits should not be treated as profit available for distribution, but should be applied in reducing the cost of the shares in the subsidiary company, since it is in the nature of a capital payment to the holding company.

In the consolidated balance sheet the holding company's share of any pre-acquisition profits should not therefore be included under General Reserve or Profit and Loss Account, as the case may be, but should be treated as a separate item, either as a Capital Reserve, or as a deduction from any Goodwill item arising out of the excess of the purchase price of the shares over their nominal value.

It will thus be observed that profits made by a subsidiary company prior to the date when its shares were acquired by a holding company must be kept separate from profits made after that date. For example, if a holding company holds nine-tenths of the issued capital of another company, which had a credit balance on Profit and Loss Account of £3,000 when the shares were acquired, £2,700 must be transferred to Capital Reserve when a consolidated balance sheet is prepared. This observation does not, however, apply to the share of profits which is attributable to the outside shareholders.

EXAMPLE.

From the following Balance Sheets of Major Co., Ltd., and its subsidiary company, Minor Co., Ltd., drawn up as at 31st December, 19.., prepare a Consolidated Balance Sheet as at that date. The interests of the minority shareholders of Minor Co., Ltd., are to be shown as a separate item. At the date of acquisition of the shares the General Reserve of Minor Co., Ltd., amounted to £2,000 and the Profit and Loss Account to £4,000.

MAJOR CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital, Authorised and Issued—		Freehold Property, at cost	20,000
100,000 Shares of £1 each	100,000	Plant and Machinery, at cost, *less* depreciation	25,000
Sundry Creditors	15,000	Shares in Minor Co., Ltd., at cost—	
General Reserve	10,000	30,000 Shares of £1 each	40,000
Profit and Loss Account	15,000	Stock, at cost	15,000
		Sundry Debtors	20,000
		Cash	20,000
	£140,000		£140,000

MINOR CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital, Authorised and Issued—		Plant and Machinery, at cost, *less* depreciation	12,000
40,000 Shares of £1 each	40,000	Stock, at cost	20,000
Sundry Creditors	4,000	Sundry Debtors	10,000
General Reserve	2,000	Cash	10,000
Profit and Loss Account	6,000		
	£52,000		£52,000

CONSOLIDATED BALANCE SHEET OF MAJOR CO., LTD., AND ITS SUBSIDIARY, MINOR CO., LTD.

As at 31st December, 19..

Liabilities.

			£
Share Capital Authorised and Issued—			
100,000 Shares of £1 each . .			100,000
Sundry Creditors			19,000
Minority Shareholders in Minor Co., Ltd.—		£	
10,000 Shares of £1 each		10,000	
Proportion of General Reserve (see below) .		500	
Proportion of Profit and Loss Account (see below)		1,500	
			12,000
Capital Reserve—			
Proportion of General Reserve (see below) .		1,500	
Proportion of Profit and Loss Account (see below)		3,000	
Deducted from Goodwill *contra* . . .		£4,500	
General Reserve—	£		
Major Co., Ltd. . .		10,000	
Minor Co., Ltd. .	2,000		
Less Minority Shareholders (see above) .	500		
Capital Reserve (see above) .	1,500		
	£2,000	–	
			10,000
Profit and Loss Account—			
Major Co., Ltd. . .		15,000	
Minor Co., Ltd. .	6,000		
Less Minority Shareholders (see above) .	1,500		
Capital Reserve (see above) .	3,000		
	£4.500	1,500	
			16,500
			£157,500

Assets.

	£	£
Goodwill, at cost [Excess of cost of shares in subsidiary over their nominal value]	10,000	
Less Capital Reserve *per contra* . .	4,500	
		5,500
Freehold Property, at cost . .		20,000
Plant and Machinery, at cost, *less* depreciation		37,000
Stock, at cost		35,000
Sundry Debtors		30,000
Cash		30,000
		£157,500

Consolidated Profit and Loss Account.

A consolidated Balance Sheet may be accompanied by a consolidated Profit and Loss Account showing the combined results of the holding company and the subsidiary companies.

The consolidated Profit and Loss Account will take the usual form of a Profit and Loss Account and all the foregoing rules with respect to the treatment of unrealised inter-company profits, pre-acquisition profits and losses, and the interests of minority shareholders in current profits, will apply: thus care should be taken to ensure that—

(1) Profits of subsidiaries which accrue prior to the date when the shares were acquired are not rendered available for distribution as dividend but are transferred to Capital Reserve. This will apply to the whole of the profits of the subsidiaries and not merely to those profits distributed as dividends.

(2) The due proportion of current profits and losses applicable to the minority interests is deducted from the total profits to show what is available for distribution within the group.

All inter-company dividends, purchases and sales, etc., will be eliminated, and care should be taken that the fund shown as the divisible fund consists solely of profits earned by the holding company and by subsidiaries since the date of acquisition of the shares by the holding company in so far as such profits may be attributed to the holding company's holding in the subsidiary company.

EXAMPLE.

Red, Ltd., is interested in two subsidiary companies, White, Ltd., and Blue, Ltd. On 31st March, 1940, Red, Ltd., acquired 20,000 Ordinary Shares of £1 each in White, Ltd. (representing the entire share capital of that company) and on the following 31st May, 18,000 Ordinary Shares of £1 each in Blue, Ltd. (the issued share capital of which was 24,000 Ordinary Shares of £1 each). All the shares are fully paid up. On the 10th July, 1940, White, Ltd., paid an interim dividend of 10% for the year ending 30th September, 1940, and on the 15th July, 1940, Blue, Ltd., paid an interim dividend of 12% for a similar period.

Red, Ltd., supplies its subsidiaries with raw materials invoiced at cost plus 25%. During the year ended 30th September, 1940, raw materials to the amount of £2,000 had been supplied to White, Ltd., and £3,000 to Blue, Ltd., of which £500 of the former and £1,000 of the latter were in stock at the 30th September, 1940.

The Profit and Loss Accounts of the three companies for the year ended 30th September, 1940, were as follows:—

Dr.	Red, Ltd. £	White, Ltd. £	Blue, Ltd. £		Red, Ltd. £	White, Ltd. £	Blue, Ltd. £ *Cr.*
To Administrative and Selling Expenses	5,000	3,000	4,000	By Profit on Trading and Sundry Income	17,000	10,000	8,200
,, Interim Dividends		2,000	2,880				
,, Balance available	12,000	5,000	1,320				
	£17,000	10,000	8,200		£17,000	10,000	8,200

Prepare a Consolidated Profit and Loss Account of Red, Ltd., and its subsidiary companies for the year ended 30th September, 1940.

CONSOLIDATED PROFIT AND LOSS ACCOUNT
OF RED LTD., AND ITS SUBSIDIARIES
FOR THE YEAR ENDED 30TH SEPTEMBER, 1940.

Dr.	£		*Cr.* £
To Administrative and Selling Expenses .	12,000	By Profit on Trading:— £	
,, Minority Interests in Blue, Ltd.— ¼ of (£2,880 + £1,320)	1,050	Red, Ltd. . . . 17,000	
,, Pre-acquisition Profits:—		*Less* Interim dividends from— £	
White, Ltd.— ½ of £7,000 . .	3,500	White, Ltd. 2,000	
Blue, Ltd.— ⅔ of (£4,200 − £1,050)	2,100	Blue, Ltd. 2,160	
,, Elimination of inter-company profit on stocks of White, Ltd. and Blue, Ltd.:— £		4,160	
White, Ltd., 20% of £500 100		12,840	
Blue, Ltd., 20% of £1,000 . 200	300	White, Ltd. . . . 10,000	
		Blue, Ltd. . . . 8,200	31,040
,, Balance available .	12,090		
	£31,040		£31,040

Valuation of Shares.

Preference shareholders are concerned with the maintenance of profits with a view to ensuring regular payment of the fixed dividends rather than with the value of assets. The question of capital repayment on liquidation is usually deemed to be of secondary importance to dividend maintenance.

Similarly to preference shareholders, ordinary shareholders are not greatly concerned with the actual value of assets but are interested primarily with dividend possibilities. As regards dividend possibilities ordinary shareholders may be divided into two classes:—

(*a*) Those who are anxious to receive the largest possible dividends and to let the future look after itself. These shareholders usually criticise a too prudent policy which seems to them to benefit the preference shareholders (by making possible the payment of

preference dividends out of reserves in years when trading losses are incurred) much more than themselves.

(*b*) Those who take the longer view that the setting aside of ample reserves is of the greatest benefit to the company as a whole and thus, ultimately, to themselves.

The examination of the accounts from the point of view of a shareholder or prospective shareholder raises questions of *share valuation*. Two methods of computing the value of shares are commonly employed :—

(1) THE YIELD OR CAPITALISATION METHOD.

The annual profit available for the shareholders of that class is ascertained (usually by reference to past results) and is capitalised at a rate of interest which is considered reasonable having regard to the class of share, the risk involved and the current rate of interest on gilt-edged securities. The capitalised value of the profits gives the total value of the shares of that class and by simple division the value of a single share is found.

EXAMPLE.

Motors, Ltd., have an issued capital of £20,000. The average profits for the past five years amount to £4,000. It is assumed that in a business of this type an investor would regard 10% as a fair return.

The annual average profits on this basis capitalise as follows :—

$$\frac{4,000}{1} \times \frac{100}{10} = £40,000.$$

The value of the shares may therefore be taken as :—

$$\frac{£40,000}{20,000} = £2 \text{ 0s. 0d. per share.}$$

It will be noted that under this method no further adjustment in respect of goodwill is necessary, for the super profits resulting from goodwill are included in the average profits. Since these are capitalised upon the agreed basis the capital value thus determined includes the value of goodwill (the capitalised value of the super profits).

(2) THE ASSETS BASIS.

The assets, including goodwill if it is of any value, are valued and totalled. Liabilities to outside creditors (including debenture holders) and the prior claims of other classes of shareholders are deducted and the balance represents the total value of the shares. This method can only be applied successfully to the valuation of ordinary shares which take the whole of the surplus profits and assets after satisfying the claims of preference shareholders.

EXAMPLE.

The following is the Balance Sheet of Motors, Ltd. :—

Liabilities.	£	*Assets.*	£
Issued Capital 20,000 Shares of £1 each, fully paid	20,000	Goodwill	4,000
5% Debentures	10,000	Sundry Assets	37,000
Reserve Account	4,000	Cash	3,000
Sundry Creditors	9,000		
Profit and Loss Account	1,000		
	£44,000		£44,000

Goodwill is revalued and found to be worth £3,000. Assuming that the remaining assets are of the value stated in the Balance Sheet, and that no other liabilites exist, it would appear that the shareholders are entitled to :—

	£	£
Total Assets		44,000
Less 5% Debentures	10,000	
Sundry Creditors	9,000	
Depreciation of Goodwill	1,000	
		20,000
Net assets available for shareholders		£24,000

On this basis the shares are worth :—

$$\frac{£24{,}000}{20{,}000}=£1\ 4s.\ 0d.\ \text{per share.}$$

For examination purposes, both methods of valuation of shares can be adopted and the results averaged. Thus, if this suggestion is applied to the valuations in the above examples, the value of each ordinary share will amount to :—

$$\frac{£2\ 0s.\ 0d.+£1\ 4s.\ 0d.}{2}=£1\ 12s.\ 0d.$$

EXERCISE 9.

A. Distinguish between a Reserve Fund and a Reserve Account. Give examples of each and describe their origin and their treatment in the books and accounts.

B. Differentiate between a Reserve, a Reserve Account, a Reserve Fund, and a Sinking Fund.

C. On 1st January, 19.., the Reserve Account of a company has a credit balance of £500, and on 31st December, 19.., £700 of the profits for the year are transferred to the same account. Draw up a Reserve Account incorporating these items, and show how you would deal with the balance in the Balance Sheet at the end of the year.

If the balance of the Reserve Fund were invested outside the business altogether, how would you show that amount in the Balance Sheet? Give an extract from a Balance Sheet, using the above figures.

D. What are Secret Reserves? Give examples showing how they may be created and utilised.

E. The directors of a company with an authorised capital of £500,000, subscribed and paid up, decided to recommend the payment of a dividend of 5%. You are requested to advise as to the formalities incidental to the payment of this dividend and also to draft the rulings for a dividend list.

F. The Profit and Loss Account of a limited company showed a balance available for distribution of £9,313 17s. 2d. as on 30th June.

It was decided to deal with this balance as follows:—

(*a*) To pay a year's dividend on 10,000 6% Preference Shares of £1 each, less Income Tax.
(*b*) To pay a year's dividend on 20,000 Ordinary Shares of £1 each at the rate of 10% free of Tax.
(*c*) To transfer £3,000 to Reserve Account.
(*d*) To carry forward the balance.

Assume that the rate of tax for the fiscal year was 10s. in the £.

Give the entries necessary to carry these decisions into effect and show the Appropriation Account of the company.

G. The Allington Co., Ltd., declared a dividend of 6% on the Preference Shares for the year ended 31st March, 19.., according to the amounts paid up thereon. The following are the particulars in accordance with the Register of Preference Shares from which you are required to prepare the Preference Share Dividend Book, assuming that the rate of tax for the fiscal year was 10s. in the £:—

			£
A. Black, amount	paid up	on shares	4,500
W. Jones,	”	”	6,750
J E. Benson,	”	”	4,500
G. Salmon,	”	”	7,950
W. A. Smith,	”	”	3,000
L. P. Sergeant,	”	”	2,850
G. Lupin,	”	”	3,675
S. Stanley,	”	”	2,175
L. A. Evans,	”	”	4,500
P. Redfern,	”	”	1,500
M. Barnett,	”	”	1,500

H. Give the necessary entries (using imaginary figures) to record the payment of a dividend by a company:—

(1) Where the dividend is paid "less tax."
(2) Where the dividend is paid "free of tax."

Why is it not usual to pay dividend on preference shares "free of tax"?

I. Upon £10,000 6% Cumulative Preference Shares dividends of 3%, 3% and nil are paid in three successive years. Show how you would deal with the arrears in the books of the Company issuing the shares.

J. The Sun Engineering Company, Limited, was incorporated on the 1st April, to take over a business as a going concern from the previous 1st January. The turnover up to the 31st March was £10,000, and from the 1st April to 31st December, £26,000. Assuming that the net profit for the year

was £7,500, you are required to ascertain the profit prior to incorporation, and state how such profit should be dealt with.

Are there any items which may be charged against profits made prior to the date of incorporation?

K. A limited company with a nominal capital of £40,000 in shares of £1 each and a Reserve Account of £80,000, the issued and paid-up capital being £4,000, decides to pay a Bonus of £9 per share out of the Reserve by the issue of fully-paid shares. Give the journal entries necessary to record this transaction, and show how the next Balance Sheet of the Company will be affected.

L. May, Queen & Co., Ltd., having made substantial profits, but needing cash, decided to pay a dividend to its shareholders in the form of fully paid shares. The balance standing to the credit of the Profit and Loss Account amounted to £10,876 15s. 2d. The nominal capital of the company consisted of 200,000 Ordinary Shares of £1 each. 100,000 of these shares had been issued and were fully paid. The proposed dividend was to take the form of an issue of two fully paid shares for every twenty-five shares held.

Show the entries necessary to record these transactions in the books of the company, assuming that no shareholder holds fewer than twenty-five shares.

M. Bars, Limited, have accumulated a Reserve Account of £50,000. The nominal capital of the company consists of 300,000 Shares of £1 each, of which 200,000 Shares have been issued and fully paid up. The directors propose to distribute the Reserve Account by the issue of one fully paid share for every four shares held. What is your opinion of this proposal? Give the entries necessary in order to record the new issue of shares in the company's books and Balance Sheet.

N. The Balance Sheet of The Highland Hotel Co., Ltd., disclosed the following particulars:—

	£	£
CAPITAL:—		
Nominal— 20,000 6% Preference Shares of £5 each	100,000	
150,000 Ordinary Shares of £1 each	150,000	
	£250,000	
Issued—10,000 6% Preference Shares of £5 each, fully paid	50,000	
100,000 Ordinary Shares of £1 each, fully paid	100,000	
		150,000
Reserve Account		50,000
Profit and Loss Account (balance)		20,000

Resolutions were passed at extraordinary general meetings of the company as follows:—

(*a*) To convert each £5 preference share into five preference shares of £1 each.

(*b*) To declare a bonus of 20% on the ordinary shares, to be provided—(1) As to one moiety from the profit and loss balance, and (2) the other moiety from the reserve fund—the bonus to be satisfied by the issue of one fully paid ordinary share for every five ordinary shares held.

Submit the journal entries necessary to record the transactions resulting from the above resolutions, and show how the accounts affected would appear in the Balance Sheet of the company.

O. Show by means of ledger accounts how the following decisions of the directors of the Wintergreen Co., Ltd., should appear in the books of the company :—

(i.) Transfer of £2,000 from Profit and Loss Account to Reserve Account in order to bring up the latter to £18,000.

(ii.) To pay a dividend of 100% on the Share Capital of £1,800.

(iii.) To pay a bonus of £2 per share (on 1,800 shares of £1 each) out of the Reserve Account in fully-paid shares.

The profit for the year in question amounted to £10,000, and the balance of Profit and Loss Account at the beginning of the year was £6,000. Ignore Income Tax.

P. The Balance Sheet of the Lionheart Co., Limited, as at 31st December, was as follows :—

Liabilities.	£	*Assets.*	£
Share Capital (authorised and issued)—		FIXED ASSETS—	
100,000 Preference Shares of £10 each	1,000,000	Freehold Works, Plant and Machinery at cost	3,602,474
200,000 Ordinary Shares of £10 each	2,000,000	Freehold Estates at cost	106,760
Mortgage Debentures	1,200,000	Steamers at cost	164,453
Creditors	145,523	Rolling Stock at cost	128,721
Insurance Reserve	5,577	Furniture at cost	1,216
General Reserve	108,823	Shares in Subsidiary Companies at cost	134,807
Profit and Loss Account	47,770	FLOATING ASSETS—	
		Stocks	137,051
		Debtors	93,657
		Bank	137,216
		Cash	1,338
	£4,507,693		£4,507,693

A scheme for the reduction of the capital, approved by the court, was adopted by which £4 per share was to be written off the Preference Shares, and £6 per share off the Ordinary Shares. The scheme provided for the undermentioned reductions in the assets, as at 31st December :—

	£
Freehold Works by	1,572,014
Freehold Estates by	6,760
Shares in Subsidiary Companies by	62,610
Steamers by	40,453
Rolling Stock by	33,721

and that the General Reserve should be extinguished and the difference be transferred from Profit and Loss Account.

You are required to draft the Balance Sheet of the company, after carrying out the terms of the scheme as set out above.

Q. A limited company having sustained heavy losses obtained the sanction of the court to reduce its capital from 100,000 shares of £1 each, 10s. per share paid up, to 100,000 shares of £1 each, 5s. per share paid up. Make the necessary journal entry and state how the share ledger and certificates will be adjusted

R. With a view to reducing establishment expenses and generally to effect economy in working, Anstruther & Co., Ltd., was taken over by Brown's, Ltd., as from 1st January, upon the following terms :—

(i) Brown's, Ltd. to assume the liabilities and take over the assets at book values.

(ii) Brown's, Ltd. to discharge the debentures in Anstruther & Co., Ltd., at 105% by the issue of new mortgage debentures at 6% in Brown's, Ltd.

(iii) Brown's, Ltd. to pay the shareholders in Anstruther & Co., Ltd., 10s. per share, and to give three 10s. shares in the former company for every £1 share in the latter company. The 10s. shares were considered as being at par.

The following Balance Sheet of Anstruther & Co., Ltd., was prepared immediately before the transfer :—

Liabilities.	£	*Assets*	£
Capital—		Goodwill at cost . .	35,000
Nominal, 50,000 Shares of £1 each . . .	50,000	Fixed Assets—	
Issued, 47,500 Shares of £1 each, fully paid . .	47,500	Freehold Land and Buildings at cost . . .	15,650
5% Mortgage Debentures .	12,000	Machinery and Plant at cost, less depreciation .	3,210
Reserve Fund . . .	15,000	Fixtures and Fittings do. .	850
Sundry Creditors . .	7,650	Floating Assets—	
Profit and Loss Account .	4,960	Stock	4,660
		Sundry Debtors . .	10,990
		Investments . . .	14,650
		Cash at Bank and in hand	2,100
	£87,110		£87,110

You are required to give the entries necessary to close off the books of Anstruther & Co., Ltd., and to show how the acquisition of the new business would be recorded in the books of Brown's, Ltd.

S. From the following figures, which are extracted from the books of the Gordon Shipbuilding Company, Limited, which had an authorised share capital of 20,000 Ordinary Shares of £1 each, you are required to prepare Trading Account, Profit and Loss Account, and Balance Sheet as at 31st December :—

	£
Land and Buildings at cost	6,500
Share Capital :—	
12,000 Ordinary Shares of £1 each, fully called . .	12,000
Calls in Arrear	40
5,000 Ordinary Shares of £1 each, 10s. paid up . .	2,500
Goodwill at cost	2,600
Discount on Debentures	100
Plant and Machinery at cost, less depreciation . .	4,245
Rent, Rates, Taxes, and Telephone	400
Fuel, Power and Lighting (Manufacturing) . . .	178
Wages (Manufacturing)	1,676
Insurance	240
Directors' Fees	500
Purchases (net)	9,981
Sales (net)	17,900
Discount Received	140
Discount Allowed	100
Fixtures and Fittings at cost, less £10 depreciation . .	390
Office Furniture, etc., at cost	100
Mortgage Debentures, 5%	2,000
Interest on Debentures	100
Bad Debt Reserve	500
Salaries	1,400
Carriage Inwards	150

	£
Carriage Outwards	170
Sundry Debtors	2,100
Sundry Creditors	1,720
Cash at Bank	1,400
Cash in hand	50
Stock at 1st January	3,780
Incidental Trade Expenses	

The Stock at 31st December was £2,510. Write off the Debenture Discount. Take into consideration the following adjustments: Increase Bad Debt Reserve to £750, Rates owing £84, 1s. 0d.

T. Draw up Balance Sheet and Profit and Loss Account of the Afridi Co., Ltd., as at 31st December. The Trial Balance is as follows:—

	£	£
Balance at Bank	980	
Sundry Debtors	6,780	
Bills Receivable	480	
Wages paid in advance	42	
Plant and Fixtures at cost, less depreciation	4,060	
Goodwill Account at cost	10,045	
Interest on Debentures	400	
Stock Account, 1st January	20,098	
Purchases	12,480	
Ready Money Purchases	340	
Wages	13,380	
Discounts Allowed	706	
Rent, Gas, Insurances, etc.	1,430	
Managing Director's Salary	1,000	
Bank Charges and Interest	101	
Sundry Expenses	1,150	
Rent and Insurances in advance	200	
Bad Debts	125	
Depreciation of Plant	203	
Legal Charges	42	
Profit and Loss Account—		
Balance brought forward	271	
Share Capital authorised and issued—		
Preference		8,000
Ordinary		20,000
5% Mortgage Debentures		8,000
Trade Creditors		6,630
Bills Payable		1,160
Bank Loan (Secured)		1,000
Sundry Creditors		1,861
Reserve for Amounts owing—Gas, etc		30
Discounts Received		640
Sales		25,761
Ready Money Sales		1,231
	£74,313	£74,313

NOTE—Stock at end of the year, £23,040.

U. The Lancaster Engineering Company, Limited, has an authorised capital of £75,000, divided into 25,000 Preference Shares of £1 each, and 50,000 Ordinary Shares of £1 each. At 30th September, 1941, the whole of the Preference Shares had been issued, but the unpaid calls amounted to £1,900. Of the Ordinary

Shares 10,000 had been issued as fully paid to the vendors for the purchase price of their connection; 40,000 remain to be issued. The company was formed in September, 1940, and the directors require a Balance Sheet and Trading and Profit and Loss Accounts to be prepared from the following particulars as at 30th September, 1941:—

	£
Factory Buildings at cost	8,700
Plant and Machinery at cost	9,100
Loose Tools at cost	186
Head Office Furniture and Fittings at cost	460
Factory Furniture and Fittings at cost	66
Chemistry Laboratory Apparatus	95
" " Materials unused	75
Purchases of Finished Articles	2,600
Returns and Allowances on Purchases	25
Sales Finished Articles	3,900
Returns and Allowances on Sales	62
Rent—Factory, 3 quarters	300
" Head Office	240
Preliminary Expenses	219
Advertising	394
Managing Director's Remuneration	500
Law Charges	30
Postages and Telegrams—Head Office	97
" " Factory	11
Salaries—Head Office	855
" Factory	250
Wages—Factory	711
General Expenses Head Office, including Stationery	490
Sundry Debtors	900
" Creditors	600
Cash at Bank	1,284

The directors desire to see the expenses of the Head Office and the Factory separately.

The stock of finished articles at the end of the period was agreed to be taken at a nominal figure of £200.

There are adjustments under the head of Rents. The Office Rent has been paid three months in advance, but the Factory has one quarter due to 29th September, 1941.

Having regard to the fact that the Factory was new and the Plant just established it was decided that the depreciation be reckoned at the rate of 2½% per annum on the cost, and on Loose Tools 5%. The cost of the laboratory can remain.

V. A company was formed to acquire the business of *X* and *Y* as a going concern on 1st January.

The amounts standing to the credit of *X* and *Y* were £9,786 and £7,644 respectively on this date, and the purchase agreement provided 9,000 fully paid shares should be allotted to *X* and 7,000 to *Y* in part consideration for the sale, and that each partner should receive in cash ¼ of the amount standing to his credit as additional consideration. The company had a nominal capital of £50,000, divided into 50,000 shares of £1 each, of which 22,000 were issued (at a premium of 1s. per share and fully subscribed) in addition to the shares allotted to *X* and *Y*. Goodwill stood in the vendor's Balance Sheet at £2,860. The shares were issued and cash duly paid to the vendors.

The agreement for sale further provided that any bad debts incurred during the first year of the company's existence should be borne as to one-third by the company and one-third each by *X* and *Y*.

In addition to any balances represented by the above information, the

following balances were extracted from the books of the company on 31st December.

	£
Stock, 1st January	12,752
Rates, Taxes and Insurance	983
Freehold Premises at cost	9,645
Purchases	47,862
Purchases Returns	951
Bad Debts	348
Plant and Machinery at cost	3,950
Factory Cash Imprest	50
Sales	98,310
Sales Returns	1,214
Discount Account (Debit Balance)	872
Furniture and Fittings at cost	1,440
Managing Directors' Salaries	2,000
Office Salaries	6,403
Works Wages	12,815
General Expenses	2,621
Motors at cost	3,700
Manufacturing Expenses	2,195
Audit Fee and Legal Expenses	327
Advertising	6,718
Fuel and Power	415
Carriage on Purchases	912
Carriage on Sales	315
Sundry Debtors	16,940
Sundry Creditors	5,340
Bills Payable	1,920
Cash at Bank	3,815
Cash in Hand	89

You are required to prepare Trading and Profit and Loss Accounts for the year ended 31st December, and a Balance Sheet as on that date.

When preparing these Accounts the following adjustments are necessary:—

(*a*) 10% depreciation is to be written off Plant and Machinery 15% off Motors, and 5% off Furniture and Fittings.

(*b*) A reserve for Bad Debts is to be created amounting to 5% of the Sundry Debtors, and reserves for discounts of 2½% on the Debtors (before deducting the reserve for Bad Debts) and of 2½% on the Creditors.

(*c*) Six months' rent of premises sub-let at £100 p.a. is to be provided for

(*d*) A Pension Fund is to be created, the Company contributing an amount equal to that contributed by the employees. All salaried employees, with the exception of the Managing Directors, who do not participate, have had their contribution of 5% of their salaries deducted when the salaries were paid, the amount debited to salaries being the actual amount paid.

(*e*) The Stock on hand on 31st December was valued at £6,486.

W. A limited company was formed on 1st January, 19.., with a nominal capital of £25,000, divided into 25,000 shares of £1 each to take over, as a going concern, the business of A. B It was agreed that the purchase consideration should be 20,000 fully-paid shares which were duly allotted to A. B. and his nominees, but no entries were made in the books in connection with the capital transactions, A. B.'s capital remaining as a balance in the books. No further share issue was made, and the following Trial Balance was extracted from the books on the 31st December, 19..

TRIAL BALANCE.

	£	£
Capital Account		15,704
Stock, 1st January, 19..	9,682	
Salaries	5,947	
Plant and Machinery at cost	9,740	
Rent, Rates and Taxes	2,372	
Purchases	69,860	
Do. Returns		2,715
Insurance	294	
Office Expenses	1,237	
Furniture and Fixtures at cost	2,960	
Bad Debts	270	
Sales		116,914
Do. Returns	836	
Commission	3,292	
Bills Receivable	1,124	
Factory Wages	9,674	
Stable Expenses	437	
Repairs	1,596	
Manufacturing Expenses	2,312	
Advertising	11,654	
Horses and Carts at cost	925	
Carriage Inwards	1,362	
Carriage Outwards	827	
Discounts Allowed	1,251	
Factory Power	1,370	
6% Mortgage Debentures (issued on 1st July)		12,000
Discounts Received		922
Lighting and Heating	199	
Sundry Debtors	37,860	
Sundry Creditors		29,840
Cash Book Balance	1,014	
	£178,095	£178,095

You are required to prepare for the company Trading and Profit and Loss Accounts for the year ended 31st December, 19.., and a Balance Sheet as on that date.

Before preparing these accounts the following adjustments must be made :—

(*a*) The following depreciations are to be written off :—
Plant and Machinery 10%.
Furniture and Fixtures 5%.

(*b*) A valuation of Horses and Carts was made which amounted to £815.

(*c*) Rates and Insurance, paid in advance, were £97 and £36 respectively.

(*d*) A Reserve must be made for interest due on Debentures to 31st December, 19..

(*e*) A Reserve for Bad Debts is to be created, amounting to 5% of the Sundry Debtors.

(*f*) One half of the Advertising is to be carried forward.

(*g*) The Stock on 31st December was valued at £4,779.

X. From the following Trial Balance of the Pimlico Mortgage Co., Ltd., as on 31st December, prepare Profit and Loss Account and Balance Sheet.

Depreciate office furniture and fittings at the rate of 10% per annum. Provide a reserve in respect of the foreclosed mortgages account of 12½%. You find that a quarter's rent receivable, amounting to £600, has been omitted from the books. (Ignore income tax on this item.) The market value of the investments representing the reserve fund is £48,500.

TRIAL BALANCE.

	£	£
Share Capital, authorised and issued, 100,000 shares of £10 each, £5 paid		500,000
Four per cent. mortgage debenture stock		250,000
Five per cent. mortgage debentures		200,000
Loans on mortgage	750,000	
Freehold buildings at cost	80,000	
Investments at cost (representing the Reserve Fund)	50,000	
General Investments at cost	40,000	
Foreclosed Mortgages Account	70,000	
Treasury bills at cost	34,750	
Office furniture and fittings at cost	750	
Sundry debtors	8,000	
Cash at bankers	7,500	
Reserve fund		50,000
Reserve for Income Tax		13,000
Discount on Company's own debentures purchased below par		23,000
Sundry creditors		2,500
Salaries	4,500	
Interest on debentures and debenture stock	20,000	
Debtors for interest on loans on mortgage accrued due	20,000	
Transfer fees		100
Office expenses	8,700	
Profit and Loss Account balance at 1st January		6,000
Audit fee	200	
Interim dividend paid 1st July	15,000	
Interest on loans and investments		63,000
Rents received		1,800
	£1,109,400	£1,109,400

NOTES.—£200,000 5% Mortgage Debentures have been redeemed and are capable of being re-issued.

The salaries (£4,500) include £2,000 directors' fees and £500 salary paid to the managing director.

A loan of £3,000 had been made to a director during the year, but this was repaid on 30th December.

Y. From the following figures relating to the Provincial Soap Co., Ltd., prepare Balance Sheet as at 31st December, 1940:—

	£
Share Capital—	
Authorised—	
50,000 7% Preference Shares of £1 each	50,000
40,000 8% Redeemable Preference Shares of £1 each, to be redeemed on or before 31st December, 1950	40,000
60,000 Ordinary Shares of £1 each	60,000
Issued—	
50,000 7% Preference Shares of £1 each, fully paid	50,000
40,000 8% Redeemable Preference Shares of £1 each, fully paid	40,000
40,000 Ordinary Shares of £1 each, fully paid	40,000
20,000 Ordinary Shares of £1 each, issued at a discount of 2½% fully paid	20,000
5% Mortgage Debenture Stock	75,000
Debenture Stock redeemed and capable of being re-issued	25,000

	£
Debenture Interest accrued due	1,250
Sundry Creditors	40,375
Bills Payable	5,000
Secured Loans	2,000
Debts due to Subsidiary Companies	2,300
Debenture Stock Redemption Fund	10,000
Profit and Loss Account—Balance 1st January, 1940	17,060
Trade marks at cost	500
Interest on Loans accrued due	100
Directors' Fees accrued	2,500
Capital Redemption Reserve Fund	15,000
Net Profit to 31st December, 1940	12,165
Patents at cost, less £3000 written off	2,000
Directors' Fees payable by subsidiary companies	500
Preference Dividend paid	6,700
Goodwill at cost	25,000
Freehold Properties at cost	50,000
Leasehold Properties at cost, less £25,000 depreciation	55,000
Plant and Machinery as valued at 31st December, 1940	21,300
Preliminary Expenses	1,750
Debts due from Subsidiary Companies	18,610
Loans to Directors during year	5,000
Furniture and Fittings at cost	1,300
Investments in shares of Subsidiary Companies at cost	25,000
Investments in War Loan at cost	23,500
Discount on Issue of Shares not written off	250
Discount on Debentures not written off	1,000
Cash at Bank and in Hand	4,300
Amounts repaid by Directors on Loan Account	5,000
Stock in Trade as valued by Managing Director	22,340
Sundry Debtors	51,200
Reserve for Bad Debts	2,500

The profits of the subsidiary companies have been included in the above figures to the extent of the dividends declared by such companies, less the aggregate amount of this Company's share of losses of those subsidiary companies making losses.

Z. From the Balance Sheets given below of the Elder Co., Ltd., and the Younger Co., Ltd., prepare a Consolidated Balance Sheet of the holding company. The interests of the minority shareholders of the Younger Co., Ltd., should be shown in the Consolidated Balance Sheet.

ELDER CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital—		Freehold Property at cost	102,000
Authorised—		Leasehold Property at cost, less depreciation	42,000
150,000 Ordinary Shares of £1 each	150,000	Plant and Machinery at cost, less depreciation	24,000
Issued—		Furniture and Fittings as valued by Smith & Son	840
150,000 Ordinary Shares of £1 each, fully paid	150,000	Shares in Younger Co., Ltd., at cost—16,000 Shares of £1 each	20,000
General Reserve Account	30,000	Sundry Debtors	26,000
Sundry Creditors	32,000	Debts due from Subsidiary Company	3,160
Debts due to Subsidiary Company	4,500	Cash at Bank	11,000
Profit and Loss Account	12,500		
	£229,000		£229,000

YOUNGER CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital—		Leasehold Property at cost, less depreciation	12,000
Authorised—		Plant and Machinery at cost, less depreciation	9,000
20,000 Ordinary Shares of £1 each	20,000	Investments at cost	5,000
Issued—		Sundry Debtors	8,150
20,000 Ordinary Shares of £1 each, fully paid	20,000	Cash at Bank	3,050
Sundry Creditors	7,200		
General Reserve Account	5,000		
Profit and Loss Account	5,000		
	£37,200		£37,200

AA. From the Balance Sheets given below of The Tiny Motor Co., Ltd., and its two subsidiary companies, the Round Tyre Co., Ltd., and the Everlasting Engine Co., Ltd., drawn up as at 31st December, 19.., prepare a Consolidated Balance Sheet of the whole undertaking. The interests of the minority shareholders in the subsidiary companies should be shown in the Consolidated Balance Sheet. At the date of acquisition of the shares in the Round Tyre Co., Ltd., the General Reserve of that company amounted to £3,000.

THE TINY MOTOR CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.		£	*Assets.*		£
Share Capital, Authorised and Issued—			Goodwill at cost		25,000
200,000 Ordinary Shares of £1 each, fully paid		200,000	Buildings at cost, less depreciation		80,000
Sundry Creditors		40,000	Plant and Machinery at cost, less depreciation		30,000
General Reserve		30,000	Stock (per manager's valuation)		17,000
Profit and Loss Account—	£		Sundry Debtors—	£	
Balance brought forward	5,000		Round Tyre Co., Ltd.	2,000	
Add Profit for year	7,000		Trade Debtors	35,000	
		12,000			37,000
			Bills Receivable (accepted by Everlasting Engine Co., Ltd.)		5,000
			Investments at cost—	£	
			War Loan	18,000	
			Round Tyre Co., Ltd.— 20,000 Ord. Shares of £1 each	25,000	
			Everlasting Engine Co., Ltd.— 8000 Ord. Shares of £1 each	12,000	
					55,000
			Cash at Bank		32,000
			Cash in Hand		1,000
		£282,000			£282,000

THE ROUND TYRE CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital, Authorised and Issued— 25,000 Ordinary Shares of £1 each, fully paid	25,000	Goodwill at cost	10,000
Sundry Creditors (including Tiny Motor Co., Ltd., £2000)	6,000	Buildings at cost	6,000
General Reserve	5,000	Machinery at cost, less depreciation	12,000
Profit and Loss Account	5,800	Stocks (per manager's valuation)	500
		Sundry Debtors	6,000
		Cash at Bank	7,100
		Cash in Hand	200
	£41,800		£41,800

THE EVERLASTING ENGINE CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Share Capital, Authorised and Issued— 10,000 Ordinary Shares of £1 each, fully paid	10,000	Buildings at Cost	7,500
Sundry Creditors	2,000	Plant and Machinery at cost, less depreciation	1,200
Bills Payable (including Bills drawn by Tiny Motor Co., Ltd., £5,000)	6,000	Stock (per manager's valuation)	7,000
Profit and Loss Account	1,300	Sundry Debtors	2,400
		Cash at Bank	1,100
		Cash in Hand	100
	£19,300		£19,300

BB. The following is the Balance Sheet of Phoenix Ltd., as at 31st December 19.. :—

Liabilities.		£	*Assets.*	£
Authorised and Issued Capital:— 80,000 Shares of £1 each fully paid up		80,000	Land and Buildings	25,000
Five per cent. Debentures (secured by a floating charge)	£ 50,000		Plant and Machinery	60,000
Accrued Interest	2,500		Stocks and Work-in-Progress	23,500
		52,500	Sundry Debtors	24,900
Sundry Creditors		28,500	Cash Balances	2,600
			Profit and Loss Account	25,000
		£161,000		£161,000

(NOTE.—The fixed assets are valued at cost less depreciation.)

The Debentures are held by Excelsior Ltd., who also hold 20,000 shares, acquired during the past two years at a total cost to that company of £14,500.

Negotiations between the two companies resulted in an agreement for the absorption of Phoenix Ltd. by Excelsior Ltd. upon the following terms:—

(1) That Excelsior Ltd. take over the assets and liabilities of Phoenix Ltd. as at 31st December, 19.., at their book figures, subject to the revaluation of the Plant and Machinery at £45,000.

(2) That the amount due in respect of the Debentures be set off against the purchase consideration, and that they be cancelled on the completion of the transaction.

(3) That the outside shareholders (i.e., the shareholders other than Excelsior Ltd.) in Phoenix Ltd., be given £1 shares issued at par by Excelsior Ltd. on the basis of such shares being worth 30s. each and the shares in Phoenix Ltd. being worth 10s. each.

The arrangement was approved by the necessary majority of shareholders in Phoenix Ltd., on 16th February, 19...

Show the Journal entries required to close the books of Phoenix Ltd., and to record the transaction in the books of Excelsior Ltd.—including the transfers required to close the accounts therein relating to the shares and debentures in Phoenix Ltd.

CC. On 31st December, 19.., an accountant prepared the following summary representing the Balance Sheet of a company :—

X LIMITED.

SUMMARISED BALANCE SHEET—31ST DECEMBER, 19..

Liabilities.	£	*Assets.*	£
Capital (Authorised, Issued and Paid up)—		Goodwill	8,000
30,000 Ordinary Shares		Fixed Assets	15,000
of £1 each	30,000	Floating Assets	6,000
Current Liabilities	10,000	Profit and Loss	11,000
	£40,000		£40,000

In order to relieve the financial stringency disclosed, the following scheme was agreed to and all the consequent legal technicalities were properly completed :—

(*a*) The directors, by resolution dated 31st January, 19.., valued the goodwill at £6,000.

(*b*) Messrs. A. & Co., licensed valuers, certified the value of the fixed assets as £12,000, by certificate dated 31st January, 19...

(*c*) The Profit and Loss Account balance was eliminated.

(*d*) The ordinary shareholders were each given the option of subscribing in respect of each ten shares held *either* :—

(i) Ten preference shares of £1, issued as 15s. paid, against a cash payment of 18s. per preference share. These shares were to carry a cumulative dividend of 5% per annum.

or (ii) One debenture bond of £10 at par, all bonds ranking *pari passu* as a specific charge on the company's fixed assets and carrying 2% per annum interest. The company reserved the right to refuse this option if more than 1,000 bonds were applied for.

(*e*) Ordinary shareholders holding 10,000 shares accepted option (i) and those holding 9,000 shares accepted option (ii), and all money due was paid. The remaining shareholders refused both options. The nominal capital of the company was increased by £10,000 so as to cover the new preference issue.

(*f*) Each ordinary share was reduced so as to rank as £1 share, eight shillings paid up. Any available balance arising out of the capital reduction was to be carried to Capital Reserve.

You are required to produce from the information given the Balance Sheet of X Limited immediately after the arrangements were completed.

DD. The following is the Balance Sheet of A.B. as at 31st December, 19.. :—

Liabilities.	£	*Assets.*	£
Creditors	50,000	Freehold Property	30,000
Bank Overdraft	13,000	Plant and Machinery	45,000
A.B.'s Capital Account	58,000	Stock	30,000
		Sundry Debtors	16,000
	£121,000		£121,000

The X Co., Ltd., agreed to take over the business of A.B. as from 1st January, 19.., and in consideration of the transfer, to

(*a*) Pay A.B. £50,000 in cash and to allot him 20,000 Shares of £1 each credited as fully paid up.

(*b*) Discharge the liabilities to the creditors and to the bank.

The authorised capital of the company was £100,000 in Shares of £1 each and, in addition to the shares allotted to A.B., 75,000 were subscribed for in cash and fully paid up.

Show the Journal entries and Ledger Accounts necessary to record these transactions in the company's books.

EE. On December 31st, 19.., the Balance Sheet of Ravary's, Ltd., was as follows :—

Liabilities.	£	*Assets.*	£
Nominal Capital, £20,000 divided into 10,000 6%. Cumulative Preference Shares of £1 each, and 10,000 Ordinary Shares of £1 each.		Land and Buildings	2,000
		Plant and Machinery	5,000
		Tools and Utensils	1,000
		Stock	7,000
		Sundry Debtors	3,000
		Bills Receivable	900
Paid-up Capital—		Cash	100
6,000 Ordinary Shares	6,000	Profit and Loss Account—	
6,000 Preference Shares	6,000	Dr. Balance	8,000
	12,000		
5% Debentures	3,000		
Sundry Creditors	5,000		
Bills Payable	3,000		
Bank Overdraft	4,000		
	£27,000		£27,000

It was decided to reconstruct the Company, and for this purpose Ravary's (New), Ltd., was registered with a Capital of £20,000 divided into 8,000 Ordinary Shares of £1 each, and 12,000 7% Preference Shares of £1 each, to take over the assets and liabilities of the old company.

The debenture-holders in Ravary's, Ltd., agreed to accept 7% Cumulative Preference Shares in Ravary's (New), Ltd. in exchange for their debentures.

The Preference shareholders in Ravary's Ltd., were to receive one Preference Share in Ravary's (New), Ltd. for every three shares held by them in the old company.

The Ordinary shareholders were to be allotted one Ordinary share, 15s. 0d. paid, in Ravary's (New) Ltd., in exchange for every four shares held by them in the old company.

The costs of the liquidation of Ravary's Ltd., were paid by the new company.

Give the Journal entries necessary to record the above transactions in the books of Ravary's Ltd.

CHAPTER X

CONSIGNMENTS ; ACCOUNTS CURRENT ; JOINT VENTURES

WHEN goods are despatched to an agent for sale and the ownership of such goods remains vested in the sender (known as the *consignor*), they are termed *consignments*.

When the agent (the *consignee*) effects a sale, the property in, and the ownership of the goods, are transferred to the buyer. Thus the goods are not at any time the property of the agent, but the latter receives payment for the goods from the buyer, and, after deducting any expenses incurred, together with his remuneration, he remits the balance (the net proceeds) to his principal. Usually, the agent's remuneration or *commission* consists of a percentage based upon the gross proceeds of the sale.

Consignments of home and foreign produce are frequently sent to merchants at central markets for sale on behalf of the consignor, as, for example, fruit, flowers, and vegetable produce to Covent Garden, and meat to Smithfield. Similarly, manufactured goods may be sent for sale to agents in this and other countries.

Del Credere Agents.

An agent sometimes undertakes to indemnify his principal against bad debts in respect of the goods sold by him, in which case he is termed a *del credere* agent, and receives an extra commission in consideration of this undertaking. In some cases this *del credere* commission is shown separately from the ordinary commission, but in other cases it is included in one rate with the ordinary commission.

Drawing a Bill against the Consignment.

In the case of consignments despatched to a foreign agent, a merchant often draws a "documentary bill" (see *ante*, page 137) upon the consignee so that it can be turned into cash by sale or discount immediately the shipment is made. Until the consignee sells the goods he is not indebted to the consignor for their value, and so cannot be expected to pay for them. On the other hand, the consignor is deprived of the use of part of his capital, and to overcome this difficulty the bill of exchange, payable at a future date, is drawn on the consignee for a certain

proportion of the value of the goods, and the consignor then sells or discounts the bill to obtain ready cash with which to finance further operations.

In all probability the goods will be sold by the consignee before the bill arrives at maturity, so that by the time he has to find the cash to meet the bill, he is actually indebted to the consignor for the proceeds of the sale of the goods, and the amount of the bill will be taken into consideration when a final settlement takes place between the two parties.

If it should so happen that the consignee cannot sell the goods, then the consignor becomes indebted to him when he meets the bill already drawn against such goods.

Entries in Consignor's Books.

The bill would be dealt with in the consignor's books as follows :—

(*a*) The bill is entered in the Bills Receivable Book, and posted therefrom to the credit of the consignee's personal account. The double entry is completed when the periodical total of the Bills Receivable Book is posted to the debit of the Bills Receivable Account.

(*b*) The Cash Book (bank column) is debited with the full value of the bill when discounted, and the amount is posted to the credit of the Bills Receivable Account.

(*c*) The Cash Book (bank column) is credited with the discount on the bill and the amount is posted therefrom either to the debit of the Consignment Account or to the debit of Bank Charges Account. Strictly speaking, the discount is a result of the trader's general financial operations, and is not a consignment expense. The better method, therefore, is to debit Bank Charges Account.

Entries in Consignee's Books.

In the consignee's books the following entries will be made :—

(*a*) Upon acceptance, the bill is entered in the Bills Payable Book, and the amount is posted therefrom to the debit of the consignor's personal account. The equalising credit entry forms part of the periodical total of the Bills Payable Book, which is posted to the credit of the Bills Payable Account.

(*b*) Upon payment of the bill, the Cash Book (bank column) is credited, and the amount is posted to the debit of Bills Payable Account.

(*c*) When the goods are sold and a final settlement is made, the amount of the bill is deducted from the net proceeds and a remittance is sent to the consignor for the balance. If the bill is paid before the goods are sold, interest is ordinarily charged to the consignor, and similarly, when the goods are sold before the due date of the bill, interest on the proceeds for the intervening period is allowed by the consignee to the consignor.

Account Sales.

When the agent has disposed of the goods, he renders to the consignor a statement showing the gross proceeds, charges incurred, and also his commission. This statement is termed an "Account Sales," and usually appears in the following form :—

ACCOUNT SALES of

54 Chests of Souchong Tea, ex s.s. "Royal Oak," at Calcutta.

Sold at public sale on *1st June,* **19..**

For account of *Messrs Arthur Andrews & Co.*

	Particulars.	Price. d.	Amount.					
Mark.	Prompt : 15th June, 19..							
C 82			£	s.	d.	£	s.	d.
	54 Chests of Souchong Tea, 2.700 lbs. .	12½ in bond.	140	12	6			
S	Discount 2½% . . .		3	10	4			
A A.						137	2	2
Nos. 1-54.	*Less* Charges :—							
	Landing and Cartage . . .		1	12	6			
	Warehousing		2	18	0			
	Fire Insurance			10	6			
E. & O. E.	Commission 5% on £140 12s. 6d.		7	0	8			
						12	1	8
London, MORLEY &	18th June, 19.. SIMPSON.					£125	0	6

NOTE.—Alternatively, the commission may be calculated on the net selling price (£137 2s. 2d.), but the basis adopted will depend upon the agreement between the consignor and consignee.

The "Prompt" date is the date on which settlement of the transaction is to be effected by the buyer. The words "in bond" indicate that the goods are lying in a bonded warehouse ; the customs duty is therefore payable by the purchaser before they can be removed.

The abbreviation "E. & O. E," meaning "Errors and Omissions Excepted," is invariably used on these statements, and also on accounts current (see *post*, page 422), with the intention of thereby reserving the right to amend the account if a mistake is subsequently discovered. It has, however, no legal significance, and the right of correction is not lost if the abbreviation is omitted.

THE TREATMENT OF CONSIGNMENTS IN ACCOUNTS

The despatch of goods on consignment is, in effect, merely a transfer of stock from one place to another, e.g., from the warehouse of the trader to that of an agent, the consignor bearing the risk of loss or damage in transit, etc. Moreover, the agent incurs no liability until he sells the goods, and, therefore, a different method of treatment from that accorded to an ordinary sale is required in the books of both consignor and consignee.

The Consignor's Books.

Where consignments are numerous, the consignor usually opens special Consignment Journals and Consignment Ledgers in which to record these transactions, and a *pro forma* invoice is invariably despatched to the agent with instructions as to the minimum prices at which the consignor desires the goods to be sold. Strictly speaking, the goods should be charged out at cost price, but in practice the *pro forma* invoice is generally made out at the approximate market values in order that the consignee shall not be able to calculate the profit made by the consignor. The entries made in the consignor's books may be summarised thus :—

1. Upon Despatch of the Consignment—

   Debit a Consignment to " A " Account with the cost price of the goods, crediting the same amount to a Consignment Outwards Account.

2. Upon Drawing Bill on Consignee—

   Debit Bills Receivable Account and credit the personal account of the consignee.

3. On Paying Expenses—

   Debit Consignment to " A " Account with expenses paid or incurred, crediting cash or a personal account, as the case may demand.

4. On Receipt of the Account Sales—

   Debit the personal account of the consignee with the gross proceeds, and credit the Consignment to " A " Account. Debit the Consignment to " A " Account and credit the personal account of the consignee with the latter's expenses and commission. The balance of the Consignment to " A " Account is in due course transferred to the Profit and Loss Account, while the balance of the Consignment Outwards Account is transferred to the Trading Account.

5. Upon Payment by the Consignee—

   Debit cash or bills receivable, as the case may require, and credit the personal account of the consignee. The latter account is now closed as far as that particular consignment is concerned.

At the close of the trading period, any consignments which are not sold must be brought into the final accounts at cost price plus a proportionate part of any charges incurred by the consignor and/or consignee *in respect of the entire consignment.* Thus, if carriage amounting to £60 has been incurred on a consignment of 100 tons, 25 tons of which remain unsold, then £15, i.e. $\frac{25}{100}$ of £60, will be added to the cost of the unsold portion and carried forward. On the other hand, if certain expenses have been incurred *in selling the* 75 *tons* no portion thereof can be carried forward as part of the value of the unsold portion of the consignment.

The Consignee's Books.

It has been previously explained that goods received on consignment by an agent for sale on behalf of the consignor do not, at any time, become the property of the consignee, and, accordingly, no entries are required in his books of account on receipt of such a consignment. Particulars may be recorded in a statistical or memorandum book for purposes of reference, but until some expense is incurred in respect of the consignment or some of the goods are sold, no ledger account is opened in the financial books of the consignee.

In making such entries as are required, a separate consignment account is sometimes opened for each consignment received, and when the goods are finally disposed of, the balance of this account is transferred to the consignor's personal account.

Usually, however, the whole of the entries are passed through the consignor's personal account, and the procedure may be summarised as follows :—

(1) If a bill of exchange drawn by the consignor is accepted, debit the consignor's personal account and credit Bills Payable Account.

(2) Debit the personal account of the consignor with any expenses incurred, and credit cash, or a personal account, as the case may require.

(3) When the goods are sold, debit the purchaser, or cash, and credit the consignor's personal account.

(4) Debit the consignor's personal account and credit Commission Account with the agreed commission in respect of the sale.

(5) Debit the consignor's personal account and credit cash with the amount of any remittances made to the consignor.

When the consignee is making up his accounts at the end of the trading period the balance (if any) of the consignor's personal

account will be included in the totals of sundry debtors or sundry creditors in the Balance Sheet, according to whether the account is in debit or credit. The balance of the Commission Account will, of course, be transferred to the Profit and Loss Account.

Any unsold portion of the consignment must not be included in the consignee's stock-in-trade, since the goods do not belong to him.

An example is appended, illustrating the foregoing methods as applied to the books of both the consignor and the consignee.

EXAMPLE.

Ellam & Co., Ltd., of London, consigned goods to the value of £1,000 to their agent, A. de Larum, in India; they paid freight, insurance, etc., £42, and they drew on de Larum at 90 days for £750; this bill Ellam & Co., Ltd., discount with their bankers, the charge therefor being £10. In due course de Larum renders an Account Sales showing the amount for which the goods were disposed of as being £1,250. He deducts his commission, which is 7½%, and expenses £10, and remits a draft on Lloyds Bank for the balance. Show the necessary ledger accounts in the books of both consignor and consignee.

Consignor's Books.

Dr. CONSIGNMENT TO A. DE LARUM. *Cr.*

	£ s. d.		£ s. d.
To Goods on Consignment	1,000 0 0	By Gross Proceeds of Consignment	1,250 0 0
,, Expenses	42 0 0		
,, Consignee's Commission and Expenses	103 15 0		
,, Profit and Loss Account	104 5 0		
	£1,250 0 0		£1,250 0 0

Dr. GOODS ON CONSIGNMENT (or CONSIGNMENT OUTWARDS ACCOUNT) *Cr.*

	£ s. d.		£ s. d.
To Trading Account	1,000 0 0	By A. de Larum	1,000 0 0

Dr. BILLS RECEIVABLE. *Cr.*

	£ s. d.		£ s. d.
To A. de Larum	750 0 0	By Cash	750 0 0

Dr. INTEREST. *Cr.*

	£ s. d.		£ s. d.
To Bill No. 18	10 0 0	By Profit and Loss Account	10 0 0

Dr. A. DE LARUM. *Cr.*

	£ s. d.		£ s. d.
To Gross Proceeds of Consignment . .	1,250 0 0	By Bill Receivable .	750 0 0
		„ Commission and Expenses . . .	103 15 0
		„ Bank . . .	396 5 0
	£1,250 0 0		£1,250 0 0

Dr. EXTRACT FROM CASH BOOK. *Cr.*

	£ s. d.		£ s. d.
To Bill Receivable Discounted . .	750 0 0	By Expenses (consignment to A. de Larum) . .	42 0 0
„ A. de Larum . .	396 5 0	„ Bank Charges .	10 0 0

Consignee's Books.

Dr. ELLAM & CO., LTD. *Cr.*

	£ s. d.		£ s. d.
To Bill Payable . .	750 0 0	By Gross Proceeds of Consignment . .	1,250 0 0
„ Commission . .	93 15 0		
„ Sundry Expenses .	10 0 0		
„ Cash . . .	396 5 0		
	£1,250 0 0		£1,250 0 0

Dr. BILLS PAYABLE. *Cr.*

	£ s. d.		£ s. d.
To Cash	750 0 0	By Ellam & Co., Ltd. .	750 0 0

Dr. COMMISSION. *Cr.*

	£ s. d.		£ s. d.
To Profit and Loss Account	93 15 0	By Ellam & Co., Ltd. .	93 15 0

Dr. EXTRACT FROM CASH BOOK. *Cr.*

	£ s. d.		£ s. d.
To Ellam & Co., Ltd. .	1,250 0 0	By Ellam & Co., Ltd., Sundry Expenses.	10 0 0
		„ Ellam & Co., Ltd. .	396 5 0
		„ Bills Payable . .	750 0 0

ACCOUNTS CURRENT

An account current may be defined as a statement of account, in debit and credit form, between two persons, in which interest is charged or allowed on the various transactions recorded in the account. It is a copy of the account, over an agreed period (say 3 or 6 months), of the first person named as it appears in the ledger of the second person.

This class of account is largely used between merchants engaged in foreign trade, but is also used between agent and principal, consignee and consignor, banker and customer, etc. The account is usually in the following form :—

Jonathan Miles, Sydney, N.S.W. LONDON,......19

In ACCOUNT CURRENT with

MONKS & MARTIN.

Dr. *Interest to 31st December, 19.., at 5% p.a.* *Cr.*

Date.	Particulars.	Amount.			Days.	Products.	Date.	Particulars.	Amount.			Days.	Products.
		£	s.	d.					£	s.	d.		
	E. & O. E.												

The above represents a copy of the account of Miles in the books of Monks & Martin.

Calculating Interest in Accounts Current.

The balance of the account is adjusted to include interest, which may be calculated by any one of several methods, but the following is recommended as the most common and possibly the most simple.

THE ÉPOQUE METHOD.

The account is set out in the ordinary form, being in effect merely a transcript of the account in the trader's personal ledger ; thus, goods sent out or payments made are debited, while goods or cash receipts are credited.

Interest is calculated from the "zero date" or *époque* to the due date of each transaction, and the *époque* must be either the date of the earliest transaction or a date prior to this; e.g., the preceding 31st December.

Against each transaction, in the column headed "Days," is placed the number of days between the "zero" or *époque* and the date of the transaction; thus, if the "zero" be 31st December and the transaction takes place on the 11th February, the number of days will be 42, i.e., 31 for January plus 11 for February. Interest is not usually charged or allowed for the day upon which the transaction takes place, and in calculating the number of days either the starting date or the date of the transaction must be omitted.

The number of days having been inserted, the next step is to multiply the amount of each transaction (which is reckoned to the nearest £) by the number of days determined as indicated above, the result being extended into the column headed "Products." Interest on the *balance* of the money columns must also be included for the whole period of the account, and is calculated in the same way. Thus, if the account is balanced on 30th June and "zero" is the previous 31st December, 181 days' interest must be charged, while if 1st January is "zero," 180 days only will be charged. In order to avoid the omission of one day's interest in accounts current it is advisable to make the date of the balance brought down the same as the date of the balance carried down.

The products, on each side, are then totalled, and the balance is inserted in the normal manner. This balance of products is then converted to pounds, shillings, and pence by using the formula :—

$$\frac{\text{Balance of Products} \times \text{Agreed Rate of Interest}}{365 \times 100.}$$

The amount in £ s. d. is inserted in the money column on the *same* side of the account as the product balance appears; and the account is finally balanced off.

Although the foregoing may seem somewhat perplexing to the reader who has had little practical experience of accounts current, such accounts are by no means difficult to master, and the following example, if studied in the light of the above exposition, should render the method perfectly clear :—

EXAMPLE.

Messrs Loraine & Co., Ltd., of London, ship to Horace Pailthorpe of Smyrna, on the undermentioned dates, goods to the values indicated :—

9th January,	£876 11s. 4d.;	18th February,	£1,771 4s. 0d.;
17th April,	774 10s. 1d.;	23rd April,	654 17s. 2d.;
30th April,	153 9s. 11d.;	10th May,	927 15s. 4d.

They receive cash on account thereof as follows :—

17th January,	£821 19s. 0d. ;	15th February,	£1,620 0s. 0d. ;
19th March,	850 8s. 0d. ;	25th April,	600 0s. 0d. ;
3rd May,	150 0s. 0d. ;	12th May,	1,000 0s. 0d.

It is arranged that an Account Current shall be submitted by the shippers on the 30th June, interest being calculated at 5% per annum ; you are required to draft this account.

LONDON,

Mr H. Pailthorpe, Smyrna, *30th June,* 19..

In ACCOUNT CURRENT with

LORAINE & CO., LTD.

Dr. *Interest to 30th June, 19.., at 5°/ₒ per annum.* *Cr.*

19..		£	s.	d.	Days.	Products.	19..		£	s.	d.	Days.	Products.
Jan. 9	To Goods .	876	11	4	9	7,893	Jan. 17	By Cash . .	821	19	0	17	13,974
Feb. 18	,, ,, .	1,771	4	0	49	86,779	Feb. 15	,, ,, . .	1,620	0	0	46	74,520
Apr. 17	,, ,, .	774	10	1	107	82,925	Mar. 19	,, ,, . .	850	8	0	78	66,300
,, 23	,, ,, .	654	17	2	113	74,015	Apr. 25	,, ,, . .	600	0	0	115	69,000
,, 30	,, ,, .	153	9	11	120	18,360	May 3	,, ,, . .	150	0	0	123	18,450
May 10	,, ,, .	927	15	4	130	120,640	,, 12	,, ,, . .	1,000	0	0	132	132,000
June 30	,, Balance of Products					4,628	June 30	,, Balance of Principal, (£116 0s. 10d.)				181	20,996
	,, Interest		12	8			,, 30	,, Balance *c/d.*	116	13	6		
		£5,159	0	6		395,240			£5,159	0	6		395,240
June 30	To Balance *b/d.* E. & O. E.	116	13	6									

NOTES.—The *époque* or "zero" date is 31st December.

The amount of interest is arrived at as follows :—

$$\frac{4628 \times 5}{365 \times 100} = 12s.\ 8d.$$

Interest in Red.

Another method of dealing with accounts current is to take as the "zero date" the day on which the account is made up, the interest in this case falling on the *opposite* side to that of the balance of products. Further, it is a common practice for shipments made during one month to be charged up, not as on the date of shipment, but as on the 15th (say) of the following month.

It will, therefore, occasionally happen that an item is included in the account which, at the date of closing, is not actually "due" —e.g., goods shipped on the 11th December are charged for as from the 15th January, while the "zero" date, or date of closing, is the preceding 31st December.

Instead of interest being charged for the 15 days (31st December to 15th January) it is obviously equitable that interest should be allowed ; and although the product must be entered, with the item to which it relates, on the debit side of the account, it must be kept distinctive. For this reason it is entered in *red*

ink, and is not added with the other products, but is inserted, as " Interest in Red " in black ink in the products column on the other side of the account, and there added with the other products.

" Red ink interest " may be explained as " interest for amounts not yet due, and in respect of which credit must be given. It is entered in red ink in an account current, but is not added in with the interest items appearing in the same column. It is carried to the other side of the account, and is included in the sum of the interest there."

It will be seen that interest in red can never appear in an account current drawn up by the method described fully on the previous pages, provided the " zero date " be as early as, or earlier than, the date of the earliest transaction, so both for this and other reasons the method illustrated in the example should always be used, and the needless complication of red interest entirely avoided.

Should the account contain only a few transactions a simple method is to calculate the actual interest on each item from the due date of the transaction to the end of the period of the account. The interest is inserted in special columns and the totals inserted in the principal columns before making up the account. Obviously this would be a very tedious method where the transactions are numerous and it should, therefore, be avoided in such cases.

AVERAGE DUE DATE

The average due date is the mean or equated date upon which a single total payment may be equitably made in lieu of several payments on different dates. The method adopted to ascertain the average due date is as follows :—

(1) Fix a convenient zero date (usually the due date of the first transaction).

(2) Multiply each amount to the nearest pound by the number of days from the zero date to the due date.

(3) Divide the total of these products by the total of the amounts.

The result gives the number of days from the zero date, and thus fixes the average due date.

This method is convenient for calculating interest on partners' drawings.

EXAMPLE.

Payments are due as follows :—

£200 on 18th January ;
£300 on 12th February, and
£400 on 16th March.

What is the average due date ?

Date.	*Amount.*	*Days from 18th Jan.*	*Products.*
Jan. 18	£200	0	
Feb. 12	300	25	7,500
Mar. 16	400	57	22,800
	£900		30,300

No. of days $= \frac{30,300}{900} = 33\frac{2}{3}$ days, say 34 days.

AVERAGE DUE DATE = 34 days from 18th January = 21st February

Sometimes it is more convenient to take, say, the 1st January as zero date; the above example would then be worked as follows:—

Date.	*Amount.*	*Days from 1st Jan.*	*Products.*
Jan. 18	£200	17	3,400
Feb. 12	300	42	12,600
Mar. 16	400	74	29,600
	£900		45,600

No. of days $= \frac{45,600}{900} = 50\frac{2}{3}$ days, say 51 days.

AVERAGE DUE DATE = 51 days from 1st January = 21st February.

JOINT VENTURES

Frequently two persons agree to join together in some speculation or adventure in which their individual business capabilities and trading interests may be profitably combined. Such an arrangement is not a partnership in the strict sense of the word, and the joint relationship is usually confined to one particular transaction, although several similar transactions may be entered into by the parties. Each transaction, however, is usually a separate venture, and each person contributes goods or money as may be arranged, the resultant profits or losses being shared in the proportions agreed upon. Thus a joint venture may be regarded as a partnership for one transaction only.

The venture may take the form of the development and exploitation of a patent, one person contributing goods and services while another contributes capital for expenses and experiments. But more usually the venture consists of some trading transaction—e.g., buying a consignment of goods—or a speculative transaction in stocks and shares.

The simplest method to adopt for recording the transactions is for each person to open a "Joint Venture" Account in his ledger, which is debited with that person's expenditure and credited with his receipts on joint account. In effect, therefore,

the individual Joint Venture Accounts are treated as though they were ordinary personal accounts.

When the transaction is fully completed, each party transmits to the other particulars of his disbursements and receipts, and a combined MEMORANDUM statement is prepared showing the complete details of the transaction with the resultant profit or loss. Each party then debits the Joint Venture Account in his own ledger with his share of the profit or credits it with his proportion of the loss, and the balance of this account will represent the amount he has to receive from or to pay to the other party. Obviously, the balances of the Joint Venture Account in the two persons' books will be the same amount, but one will be a debit balance while the other will be a credit balance. The accounts will be closed by the receipt or payment of this amount.

EXAMPLE.

On 1st January, Peter George of Birmingham and Henry Oldcroft of Paris enter into a joint venture for the sale of a shipment of goods, profits and losses being shared equally between them. On 2nd February, George paid £1,000 for the goods, and in addition, Freight, £40 ; Railway Charges, £20 ; and Sundry Expenses, £25.

Oldcroft made the following payments on account of the joint venture : 6th March, Government Duty, £40 10s. ; 7th April, Warehouse Charges, etc., £14 10s. ; 9th May, Postages and Sundries, £5 10s.

On 10th May Oldcroft sold the whole of the shipment for £1,440.

Prepare statement showing the result of the combined transactions and also the ledger accounts in each person's books, assuming the final settlement between the venturers was completed on 10th May.

[MEMORANDUM] JOINT VENTURE ACCOUNT.

Dr. **Peter George of Birmingham and Henry Oldcroft of Paris.** *Cr.*

			£	s.	d.			£	s.	d.
19..						19..				
Feb.	2	To Cost of Goods	1,000	0	0	May 10	By Sales	1,440	0	0
,,	,,	,, Freight on Goods	40	0	0					
,,	,,	,, Railway Charges on Goods	20	0	0					
,,	,,	,, Sundry Expenses	25	0	0					
Mar.	6	,, Government Duty	40	10	0					
Apl.	7	,, Warehouse Charges	14	10	0					
May	9	,, Postages and Sundries	5	10	0					
,,	10	,, Balance, being Net Profit, *c/d.*	294	10	0					
			£1,440	0	0			£1,440	0	0
May	10	To P. George, one-half share	147	5	0	May 10	By Net Profit, *b/d.*	294	10	0
,,	10	,, H. Oldcroft, one-half share	147	5	0					
			£294	10	0			£294	10	0

In George's Books.

Dr. JOINT VENTURE WITH H. OLDCROFT. *Cr.*

19..			£ s. d.	19..			£ s. d.
Feb. 2	To Goods . .		1,000 0 0	May 10	By Balance, .	c/d.	1,232 5 0
" "	" Freight .		40 0 0				
" "	" Railway Charges .		20 0 0				
" "	" Sundry Expenses .		25 0 0				
May 10	" Profit and Loss Account .		147 5 0				
			£1,232 5 0				£1,232 5 0
May 10	To Balance .	b/d.	1,232 5 0	May 10	By Cash (Oldcroft)		1,232 5 0

In Oldcroft's Books.

Dr. JOINT VENTURE WITH P. GEORGE. *Cr.*

19..			£ s. d.	19..			£ s. d
Mar. 6	To Government Duty .		40 10 0	May 10	By proceeds of Sales . .		1,440 0 0
Apl. 7	" Warehouse Charges .		14 10 0				
May 9	" Postages and Sundries .		5 10 0				
" 10	" Profit and Loss Account .		147 5 0				
" 10	" Balance .	c/d.	1,232 5 0				
			£1,440 0 0				£1,440 0 0
May 10	To Cash (George)		1,232 5 0	May 10	By Balance .	b/d.	1,232 5 0

In some cases it is agreed that interest shall be charged or allowed on each party's receipts and expenditure, in which case the procedure outlined for the treatment of interest on accounts current will apply.

If accounts are prepared before the completion of the transaction the value of any unsold stock must be brought down as a debit balance on the account of the venturer holding such stock and also on the joint (memorandum) account.

If one of the venturers takes over part of the assets of the joint venture at an agreed price, his account will be credited therewith and a corresponding entry made in the memorandum account.

Where the venture is continued over a period, and involves many transactions, it is usual to open a complete set of books for

the venture. The personal accounts kept therein for each of the venturers will then partake of the nature of capital accounts, being credited with assets introduced and profits made, and debited with assets withdrawn and losses sustained. Similarly, a separate set of books should be opened when a joint banking account is used in connection with the receipts and payments of the venture.

EXAMPLE.

H. Gee and D. Greenwood enter into a joint venture to buy and sell goods, agreeing to share profits and losses in the ratio 2 : 1. A set of books is opened for the venture, and on 1st January a joint Bank Account is opened, £1,000 being contributed by Gee and £500 by Greenwood.

The following transactions took place:—

			£
Jan.	3.	Purchase of Goods for cash	1,200
„	4.	Paid Warehouse Charges	50
„	4.	Paid Freight and Insurance	80
„	26.	Sold Goods for cash	1,800
„	31.	Paid Gee—Drawings	100
		„ Greenwood—Drawings	50
Feb.	2.	Purchased Goods for cash	900
„	2.	Paid Carriage and Expenses	80
„	15.	Sold Goods for cash	850

The books were balanced off on 28th February, when Stock on Hand was valued at £260, of which £110 was taken over by Gee.

Show the entries in the Cash, Joint Venture and Capital Accounts required to record the above.

Dr. JOINT VENTURE ACCOUNT. *Cr.*

19..			£	19..			£
Feb. 28	To Purchases		2,100	Feb. 28	By Sales		2,650
	„ Warehouse charges		50		„ Gee—Stock taken over		110
	„ Freight and expenses		160		„ Stock on Hand	c/d.	150
	„ Balance—Profit—						
	Gee, two-thirds		400				
	Greenwood, one-third		200				
			£2,910				£2,910
Feb. 28	To Balance	b/d.	150				

Dr. GEE, CAPITAL ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 31	To Cash		100	Jan. 1	By Cash		1,000
Feb. 28	„ Stock taken over		110	Feb. 28	„ Profit		400
	„ Balance	c/d.	1,190				
			£1,400				£1,400
				Feb. 28	By Balance	b/d.	1,190

Dr. GREENWOOD, CAPITAL ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 31	To Cash . . .		50	Jan. 1	By Cash . . .		500
Feb. 28	„ Balance . .	*c/d.*	650	Feb. 28	„ Profit . . .		200
			£700				£700
				Feb. 28	By Balance . .	*b/d.*	650

Dr. BANK ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Gee		1,000	Jan. 3	By Goods . . .		1,200
„ 1	„ Greenwood . .		500	„ 4	„ Warehouse charges		50
„ 26	„ Sales . . .		1,800	„ 4	„ Freight and Insurance . .		80
Feb. 15	„ „		850	„ 31	„ Gee—Drawings .		100
					„ Greenwood „ .		50
				Feb. 2	„ Goods . . .		900
				„ 2	„ Carriage and expenses . .		80
				„ 28	„ Balance .	*c/d.*	1,690
			£4,150				£4,150
Feb. 28	To Balance . .	*b/d.*	1,690				

NOTE.—In their own books, the Joint Venture Accounts of Gee and Greenwood would be exactly opposite to their capital accounts in the books of the venture. Thus, in Gee's books a "Joint Venture with Greenwood Account" would be opened, which would be the converse of the "Gee—Capital Account" in the Joint Venture books.

EXERCISE 10.

A. What is an Account Sales ? In what particulars (if any) does it differ from a Consignment Account ?

On 15th October, Kenwood Bros., of London, shipped to Alden & Sons, of Durban, 60 cases of mixed Sheffield goods. These goods were invoiced *pro forma* at £32 10s. per case.

The London payments in connection with this consignment were: Insurance, £10 12s.; freight, £54 12s.; sundry charges, £3 15s.

The payments made by Alden & Sons, in South Africa, were: Storage, £16 12s.; landing charges, £6 10s.; insurance, £2 11s.

On 15th December, Alden & Sons sold 30 cases of goods at £45 per case, on 17th December 25 cases at £50 per case, and on 19th December the balance of the consignment at £51 per case. All the above sales were effected for prompt cash. A commission is payable to Alden & Sons of 2% on all sales plus 1½% *del credere* commission.

On 1st November, Kenwood Bros. drew a bill on Alden & Sons for £1,000. This draft was duly accepted.

Prepare an Account Sales showing the result of the above consignment, and show how the transactions would appear in the books of Kenwood Bros.

B. B. Ison, of London, purchased 150 chests of tea at £4 10s. per chest. On 1st July, he sent the tea to Kulmon & Co., of Amsterdam, with a note that he desired, if possible, to obtain £6 per chest for the tea.

The goods were sold by Kulmon & Co., on 31st July, at £5 19s. per chest, the charges being: Dock charges, £6 4s.; storage, insurance, etc., £3 17s. 6d.; carriage from docks, £4 12s. Kulmon & Co. are entitled to 2½% commission and 1% *del credere.*

Prepare the Invoice sent by Ison to Kulmon & Co., and the Account Sales sent by the latter firm to Ison.

C. E. F. of London and G. H. of Port Elizabeth agree to combine in a joint shipment of South African goods to the former from the latter.

It is agreed between the parties that G. H. is to draw a sight draft on E. F. for 75% of the cost price of the goods on the day of shipment.

Assume that there are no expenses in South Africa, and prepare a *pro forma* Account Sales, as rendered by E. F.

D. Messrs S. Pugh & Co. of Cardiff consign goods to the cost amount of £1,500 to their agent, H. Fairfield, Hong-Kong, on which they pay freight, insurance and charges £55, drawing on him at 90 days for £1,300. They discount the bill at Lloyds Bank, being charged £15 therefor. They receive Account Sales of the consignment for £1,729, less agent's commission, etc., £71, and a draft on the Bank of Hong-Kong for the balance.

Make the entries necessary to record the above transactions in the books of Messrs S. Pugh & Co.

E. D. Duncan, of Glasgow, and O. Samos, of Larissa, trade in conjunction by means of joint consignments. Profits or losses (including cost of discounting bills) are shared equally. Duncan purchases in the United Kingdom and Samos in the Balkans. In both cases, sight bills are drawn for the invoice price of goods purchased. Disbursements are to be settled as and when the accounts of each venture are prepared.

On 1st March, Duncan purchased, for cash, hardware goods to the value of £2,383 10s. 8d., and paid freight and shipping charges, £324 15s. 2d., insurance, £28 10s. 2d., packing and sundries, £10 8s. 4d. On the same date he drew upon Samos and discounted the bill for £2,360 4s. 1d. These goods having arrived, Samos disposed of them on 12th April, for cash, £3,384 7s. 9d., and incurred the following expenses: Dock dues and landing charges, £28 7s. 2d., duty and other expenses, £341 7s. 2d. On the same day he honoured Duncan's draft.

Prepare a statement showing the result of the consignment, and give the entries which would appear in Duncan's books.

F. Havard Bros. shipped goods to John Silver, their agent at Cape Town, on 1st September, and sent therewith a *pro forma* invoice for £578 (goods £500, freight £60, and insurance, £18). On 28th October, Silver sent an Account Sales, from which it appeared that a portion of the goods had realised £460; and, deducting expenses, £10, and commission, £25, he enclosed a draft at three months for the balance The stock remaining unsold amounted, at invoice prices, plus expenses, to £280. On 2nd November he sent another Account Sales, which showed that the balance of the consignment had realised £320; which, less £8 expenses and £10 commission, he remitted by a three months' draft.

Show how the above transactions should appear in the books of Havard Bros.

G. The undermentioned transactions took place between Durham & Co., of Birmingham, and Cook & Co., of Sydney:—

		£
1940		
Dec. 31.	Balance owing by Cook & Co. to Durham & Co. at this date	500
1941		
Jan. 7.	Durham & Co. shipped goods to Cook & Co. .	300
April 10.	Bank draft received this day by Durham & Co. from Cook & Co.	600
April 15.	Durham & Co. paid on behalf of Cook & Co.:—	
	Charges Orient Mail S.S. Co.	50
	London Packing Co., Ltd.	100

Prepare the Account Current, bearing interest at 5%, to be rendered by Durham & Co. to Cook & Co., as on 30th April, 1941.

H. Prepare from the following details an account current to be rendered to a customer. *A* ships to *B* on two months' terms from date of invoice (interest at 5% per annum account current) the following goods viz.: 2nd Jan., 1940, £140; 18th March, £312; 4th June, £285; 23rd Sept., £98; 6th Nov., £176. Payment is made by *B* as follows: 20th Feb., 1940, £100; 5th May, £75; 31st July, £200; 3rd Oct., £350; and the balance on 2nd Jan., 1941. (Ignore the fact that 1940 was a leap year.)

I. What is meant by a consignor "drawing a bill on his consignee against the goods consigned"? Show how such a bill is dealt with in the consignor's books

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J. Explain the entries made by a consignor in his books:—

(*a*) On forwarding a consignment for sale.
(*b*) On receipt of the Account Sales.
(*c*) On receiving the net proceeds.

K. A partner has withdrawn, on account of profits for half-year ended 31st December, the undermentioned amounts:—

18th July	£500
12th August	600
16th November	800

Find the average date, and calculate the interest at 5%.

L. What is the average due date of the following instalments payable under a contract?

16th March	£2,800
15th April	4,200
15th May	1,400

Draw a bill to meet the £8,400, with interest thereon, at 90 days from the average due date. Interest may be taken at 4d. per £100 per day.

CHAPTER XI

SELF-BALANCING LEDGERS; DEPARTMENTAL ACCOUNTS; TABULAR BOOK-KEEPING

IT has already been explained in Chapter IV. that the ledger is customarily divided into separate books, each recording a particular class of transaction. Thus, separate ledgers may be devoted to Sales, Purchases, Nominal Accounts, Real Accounts and Private Accounts respectively; whilst in the case of businesses of any magnitude there will be several purchases and sales ledgers subdivided in the way found most convenient for each particular business.

The invariable result of double-entry book-keeping is that "the sum of the debits equals the sum of the credits," and this applies quite irrespective of the number of ledgers that may be employed. The whole of the debit balances in the various ledgers must necessarily equal the whole of the credit balances, and a Trial Balance of the complete set of books should give an exact agreement of the debit and credit totals, and thus prove the arithmetical accuracy of the ledgers.

When the system adopted involves the balancing of the ledgers as a whole and the Trial Balance disagrees, it indicates that one or more errors exist in the ledgers; but it gives no indication as to the nature of the mistake, nor does it enable one to determine which ledger is affected. In such circumstances, the discovery and rectification of the error sometimes involves considerable labour, frequently delaying the preparation of the final accounts and temporarily dislocating the ordinary routine work of the accounting department.

Advantages of Self-Balancing Ledgers.

It is, therefore, a desirable and convenient practice to adopt a system by means of which each ledger can be balanced independently of the other ledgers. The advantages of this separate balancing are fourfold, viz.:—

(1) As errors are localised, delay in balancing is minimised, thereby saving time, money, and labour.

(2) A complete Trial Balance may be compiled before the individual personal ledger balances are abstracted,

thus facilitating the preparation of both interim accounts and draft final accounts.

(3) Where the "Adjustment" or "Control" Accounts for the personal ledgers are kept under the sole control of the chief accountant, the result is a more effective supervision of, and internal check upon, the work of the ledger clerks.

(4) Where it is not desired to reveal the contents of the Private Ledger to the clerical staff the balances on this ledger can be incorporated in total in the Trial Balance.

Moreover, the sales and purchases ledgers should be balanced at frequent intervals, e.g., of one month, so that any mistakes may be quickly rectified, but it is not essential that the other ledgers should be balanced so frequently. Hence arrangements must be made for the former to be balanced independently, without the necessity of balancing the whole of the ledger accounts of the business; and although the self-balancing principle can be used in connection with any ledger, it is in practice applied most frequently to the sales and purchases ledgers.

The Principles of the System.

In the opinion of many accountants the basic principle of a "self-balancing" ledger is that the book must contain, within its two covers, a record of the twofold aspect of all the transactions with which it deals, i.e., that the double entry has been completed within the ledger itself. One method by which this is effected is by means of an Adjustment Account (sometimes termed a "Total" or "Control" Account), which is kept at the end of the ledger and contains a summary of the totals of each class of transaction debited or credited in detail to the individual personal accounts in the ledger concerned. When, however, such a plan is adopted it is necessary also to keep an adjustment or control account containing the same entries in the general ledger. The writer shares the opinion of many other accountants that this method involves an unnecessary duplication of work with no compensating advantages, and considers that it is sufficient if the adjustment accounts appear only in the general ledger, under such titles as "Sales Ledger Adjustment Account," "Purchases Ledger Adjustment Account," etc. In this way an excellent check is provided upon the work of the ledger clerks, and the key to the whole ledger system is held by the person in charge of the general ledger—usually the accountant or some other responsible official. It is, however, proposed to explain the former system in some detail, as it is still the custom in many businesses to keep the adjustment accounts at the

back of each ledger, because such accounts provide a useful memorandum for the ledger clerks in balancing their ledgers, but the explanation should be read in conjunction with the foregoing remarks.

As has been previously stated, the adjustment account contains a summary of the transactions relating to one particular ledger or class of accounts. For example, the transactions recorded in the personal accounts of a sales ledger comprise :—

1. DEBITS for (*a*) Goods sold.
   (*b*) Interest charges.
   (*c*) Dishonoured cheques.
   (*d*) Dishonoured and renewed bills.
   (*e*) Payments to debtors for claims, etc.
   (*f*) Other charges (if any).

2. CREDITS for (*a*) Returns inwards.
   (*b*) Cash received.
   (*c*) Discounts allowed.
   (*d*) Bills received.
   (*e*) Allowances and bad debts.
   (*f*) Other credits (if any).

The whole of these particulars are recorded in the adjustment account in a summarised form, i.e., in one total for each class of transaction. In order to give effect to the fundamental principle that "every debit requires a credit," the adjustment accounts in the personal ledgers are credited in total for the various individual debits to the personal accounts, and, similarly, the adjustment accounts are debited in total for the various individual credits, as shown in the following example of an adjustment account in the sales ledger.

Sales Ledger.

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT. *Cr.*

19..			£	s.	d.	19..			£	s.	d.
Jan. 31	To Cash .		10,216	4	7	Dec. 31	By Balance .	*b/d.*	7,621	4	0
„ 31	„ Discounts .		310	2	6	Jan. 31	„ Sales .		12,424	9	6
„ 31	„ Bills Receivable .		1,265	10	0	„ 31	„ Bill Receivable Dishonoured		250	0	0
„ 31	„ Returns Inwards .		320	5	6	„ 31	„ Interest Charges .		12	10	6
„ 31	„ Bad Debts .		551	15	6						
„ 31	„ Balance .	*c/d.*	7,644	5	11						
			£20,308	4	0				£20,308	4	0
						Jan. 31	By Balance .	*b/d.*	7,644	5	11

If the postings to the General Ledger Adjustment Account have been correctly made AND if all detailed postings to the individual Sales Ledger accounts have been correctly made during the month, the balance on the General Ledger Adjustment Account should equal the total of the balances in the Sales Ledger. If it does not, then some or all of the following errors have been made :—

(i) One or more items in the Sales Ledger have been incorrectly posted from the book of original entry; *or*

(ii) An error has been made in extracting one or more of the balances in the Sales Ledger; *or*

(iii) An error has been made in posting one of the items in the General Ledger Adjustment Account (e.g., as the result of an error in adding up the Sales Day Book); *or*

(iv) An error has been made in casting one or more of the Sales Ledger accounts.

Disagreement thus indicates that the error has occurred somewhere in connection with the Sales Ledger, and the scope of the work involved in finding it is narrowed down considerably. Where several Sales Ledgers are used and each is made self-balancing, any errors which may have been made are definitely localised, and the clerks have to search only in that ledger which fails to balance, instead of having to go through them all.

The foregoing adjustment account is repeated, with the sides reversed, in the general or nominal ledger, and the effect of this repetition is to equalise or compensate the entries in the two adjustment accounts. In the general ledger the Sales Ledger Adjustment Account, which corresponds to the adjustment account shown on page 435, will appear as follows :—

General Ledger.

Dr. SALES LEDGER ADJUSTMENT ACCOUNT. *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
Dec. 31	To Balance .	*b/d.*	7,621	4	0	Jan. 31	By Cash . .		10,216	4	7
Jan. 31	,, Sales . .		12,424	9	6	,, 31	,, Discounts .		310	2	6
,, 31	,, Bill Receivable Dishonoured		250	0	0	,, 31	,, Bills Receivable .		1,265	10	0
,, 31	,, Interest Charges .		12	10	6	,, 31	,, Returns Inwards .		320	5	6
						,, 31	,, Bad Debts .		551	15	6
						,, 31	,, Balance .	*c/d.*	7,644	5	11
			£20,308	4	0				£20,308	4	0
Jan. 31	To Balance .	*b/d.*	7,644	5	11						

In the last form the adjustment account is most appropriately termed a "Total Debtors Account," and in this summarised

form it provides useful information as to the totals of the various classes of transactions affecting debtors. For instance, comparison of these totals for successive periods will indicate, to some extent, the progress or otherwise of the business.

In practice it often occurs that a few credit balances for allowances or returns exist in the sales ledger, and in such a case separate balances should be carried down on the Adjustment Account in respect of the total debit balances and the total credit balances.

Where there are debit and credit balances in both the sales and purchases ledgers, the details should be shown as follows in the Balance Sheet prepared for the internal use of the firm, although they would not appear in the published accounts :—

Liabilities.	£	s.	d.	£	s.	d.	*Assets.*	£	s.	d.	£	s.	d.
Sundry Creditors—							Sundry Debtors—						
Purchases Ledger .	5,420	10	6				Sales Ledger. .	7,458	10	0			
Sales Ledger . .	56	14	0				Purchases Ledger .	26	5	0			
				5,477	4	6					7,484	15	0

The adjustment accounts for the purchases ledgers are prepared in a similar manner to those for the sales ledgers, the totals only of the various classes of transactions being recorded in these accounts, and, as in the case of the sales transactions, the Purchases Ledger Adjustment Account appearing in the general ledger is a copy (with the sides reversed) of the General Ledger Adjustment Account in the purchases ledger. The balance of the adjustment account shows the total amount owing to various creditors at the date the account is balanced. As in the case of the Sales Ledger Adjustment Account, the total debit balances and total credit balances should be carried down separately, in order that these totals may agree with the totals of the individual debit and credit balances in the ledgers.

Examples of adjustment accounts used in conjunction with the purchases ledger are appended.

In the Purchases Ledger.

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT. *Cr.*

19..			£ s. d.	19..			£ s. d.
Dec. 31	To Balance .	*b/d.*	6,982 10 6	Jan. 31	By Returns .		506 10 0
Jan. 31	„ Purchases .		9,256 8 6	„ 31	„ Cash . .		7,102 5 6
				„ 31	„ Discount .		354 16 0
				„ 31	„ Bills Payable		2,426 15 6
				„ 31	„ Balance .	*c/d.*	5,848 12 0
			£16,238 19 0				£16,238 19 0
Jan. 31	To Balance .	*b/d.*	5,848 12 0				

In the General Ledger.

Dr. PURCHASES LEDGER ADJUSTMENT ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 31	To Returns .		506 10 0	Dec. 31	By Balance .	*b/d.*	6,982 10 6
" 31	" Cash . .		7,102 5 6	Jan. 31	" Purchases .		9,256 8 6
" 31	" Discount .		354 16 0				
" 31	" Bills Payable		2,426 15 6				
" 31	" Balance .	*c/d.*	5,848 12 0				
			£16,238 19 0				£16,238 19 0
				Jan. 31	By Balance .	*b/d.*	5,848 12 0

The Preparation of the Adjustment Accounts.

At first sight the duplication of the adjustment accounts in contra form in the different ledgers is apt to appear confusing to students new to the subject, but it is nevertheless essential that this method of applying the self-balancing principle should be thoroughly understood, as it is one which frequently forms the basis of an examination question. The books should be looked at from the point of view that the sales and purchases ledgers are each in charge of a different person, and that each person is required to balance his own ledger without reference to the other ledgers. At the same time the person in charge of the general ledger must have in his own book the requisite material to strike his balance independently.

It may, therefore, be advantageous to show :—

(1) How these adjustment accounts are prepared ;

(2) How the entries in the various books are dealt with ; and

(3) How the double-entry principle is maintained throughout.

The following summaries in columnar form indicate how the individual items and the totals are dealt with in the personal ledgers, and also how the totals are recorded in the general ledger :—

BOOKS OF FIRST ENTRY.	SALES LEDGER.	GENERAL LEDGER.
Sales Day Book. Journal Debits (for interest charges, etc.). Cash Book Credits (if any).	Individual items are posted to the debit of the personal account and totals to the credit of the General Ledger Adjustment Account.	The totals, in each instance, are debited to the Sales Ledger Adjustment Account; the equalising credits appearing in the Sales Account and other nominal accounts.
Sales Returns Book. Bills Receivable Book. Cash Book Debits. Journal Credits (for allowances, etc.).	Individual items are posted to the credit of the personal account and the totals to the debit of the General Ledger Adjustment Account.	The totals, in each instance, are credited to the Sales Ledger Adjustment Account; the equalising debits appearing in the respective nominal accounts.
Cash Book Credits will represent payments to debtors for allowances made or for goods returned. There are comparatively few entries of this nature. Dishonoured cheques and bills will also appear on credit side of Cash Book.		

BOOKS OF FIRST ENTRY.	PURCHASES LEDGER.	GENERAL LEDGER.
Purchases Book. Journal Credits (for interest charges, etc.). Cash Book Debits (if any).	Individual items are posted to the credit of the personal account and the totals to the debit of the General Ledger Adjustment Account.	In each case the totals are credited to the Purchases Ledger Adjustment Account; the equalising debit appearing in other nominal accounts.
Purchases Returns Book. Cash Book Credits Bills Payable. Journal Debits (for allowances, etc.).	Individual items are posted to the debit of the personal account and the totals to the credit of the General Ledger Adjustment Account.	In each case the totals are debited to the Purchases Ledger Adjustment Account; the equalising credit appearing in other accounts in the same ledger.
Cash Book Debits, which are of rare occurrence, represent payments received from creditors for overcharges, allowances or goods returned.		

As is shown by the above summaries an equalising credit for every debit entry, and *vice versa*, appears in each ledger for all transactions and, therefore, each ledger may be separately balanced without reference to the other ledgers. Where the ordinary form of journal is used, it will be necessary for the entries to be analysed and dissected in order to ascertain the total debits and credits respectively relating to each ledger.

In some cases a form of Transfer Journal is used, with separate money columns for the sales, purchases and general ledgers respectively, and if this method is adopted the totals for each ledger are automatically recorded. An example of such a journal is shown on page 444. Similarly, the Cash Book is provided with extra columns as illustrated in the example given on pages 446 and 447.

Where there are many personal ledgers in daily use, both for sales and purchases, skilful organisation is required in the arrangement of the subsidiary books so that the adjustment accounts may be prepared in the most convenient way possible.

Four separate methods are, in practice, adopted in varying circumstances, viz. :—

(1) A separate day book, cash book, journal, etc., is used for each ledger.

(2) Each book of original entry is provided with additional analysis columns for the dissection of the entries posted into the various ledgers.

(3) Ordinary books of prime entry are used, but when the items are posted therefrom to the ledger, the ledger folio is shown so as to indicate clearly which ledger is affected; thus "A/12," "B/101," etc. An abstract must then be made, in columnar form, of all the items in each book of prime entry showing separately the items relating to each ledger, and giving the final total for the period of such items posted to each ledger.

(4) Where machinery is utilised for posting purposes, the totals of the postings made to one set of ledger cards or one loose leaf ledger can be separately recorded.

It is difficult to say which is the best method to adopt. Each one has its own advantages, but probably a combination of the first three may be profitably used in certain circumstances. For example, where there are many sales ledgers it would be most convenient to have separate day books for each ledger, thus enabling several day book clerks to use them simultaneously, while for the Sales Returns Book (where the entries are comparatively few) the columnar form of book with analysis columns for each ledger would be most suitable. Undoubtedly, the best type of Cash Book is that in columnar form with separate books for cash received and cash paid, as illustrated on pages 446 and 447.

The third method involves a considerable amount of work in the preparation of the periodical abstracts and, therefore, can

be advantageously used only for books in which the entries are comparatively few, e.g., the journal "proper," as far as concerns the personal ledgers.

It has already been indicated that the terms "Total Account" and "Control Account" are sometimes used instead of the term "Adjustment Account," and, so far as the general ledger is concerned, the former titles are to be preferred, since the accounts they represent record in total the transactions with debtors and creditors respectively.

While it is true that by the use of self-balancing ledgers a great saving in both time and labour is effected, it has already been explained that the keeping of the adjustment accounts in both the personal ledgers and general ledger involves a certain amount of duplication of work, and the same results are achieved by the compilation of the total debtors' and total creditors' accounts in the general ledger only.

It may be argued that in this case the ledgers are not "self-balancing." Strictly speaking, however, the term itself is not a good one—a ledger cannot balance itself in any circumstances,—but to adhere rigidly to the elementary principle that "every debit must have its credit" and to insert in each personal ledger adjustment accounts which are already in the general ledger, merely for the purpose of having equal debits and credits in the ledgers, appears to be quite unnecessary, particularly as the whole advantages of the self-balancing principle can be obtained by the use of the adjustment accounts in the general ledger. These accounts may thus be regarded as memorandum accounts not affecting the "double entry" in any way, and will give all the information necessary for proving the personal ledgers without any further elaboration.

The principle of self-balancing ledgers is one which is constantly receiving the attention of the leading examining bodies, and it is, therefore, essential that examination candidates should have a thorough grasp of the principles involved. The construction of the adjustment accounts is illustrated in the following fully-worked exercise, which should be carefully studied:—

EXAMPLE.

On 30th June, 19.., the Balance Sheet of Baldwin & Cook, Wholesale Paper Merchants, disclosed the following assets and liabilities:—

	£	s.	d.
Sundry Debtors:—			
E. James	145	10	0
Yoland & Co.	234	9	0
A. Bell	154	11	6

	£	s.	d.
Sundry Creditors :—			
Cant & Son	179	14	7
Westwood & Co.	324	0	5
Furniture and Fittings	203	0	0
Stock on hand	1,060	17	11
Cash on Deposit	1,000	0	0
Cash at Bank	236	7	9
Freehold Premises	500	0	0
Bills Receivable :—			
Yoland & Co., due 12th July	293	0	0
Bills Payable :—			
Cant & Son, due 17th July	420	0	0
Do. due 18th August	404	1	2

Capital is divided as to $\frac{3}{5}$ths S. Baldwin and $\frac{2}{5}$ths to H. Cook.

Open the Sales, Purchases, and General Ledgers with the above balances, enter the following transactions in the proper subsidiary books, post to the ledgers and extract separate Trial Balances for each of the ledgers as at 31st July.

All receipts were paid to bank, and all payments were made by cheque, unless otherwise stated.

July 3. Drew cheque for Petty Cash, £35.

„ 3. Sold to Yoland & Co. :—
14 reams Azure-laid Paper, 30 lbs. per ream, at 9d. lb.
5 reams Cream-laid Paper, 21 lbs. per ream, at 10d. lb.

„ 4. Received cheque in settlement of A. Bell's account, and sold to him :—
4 cwt. Brown Paper at £16 10s. ton.
7 cwt. Brown Paper at £26 10s. ton.

„ 7. Bought of Cant & Son :—
1 ton Bank Paper, 10 lb. to ream of 480 sheets, at 5d. lb.

„ 8. Paid Cant & Son account to 30th June, less $3\frac{1}{4}$% discount.
Purchased of them 1 ton of Tissue Paper for £32, and invoiced same to E. James at 3s. per ream, each ream weighing 7 lbs.

„ 10. Sold to E. James :—
5 cwt. Brown Paper at £16 ton.
$\frac{1}{4}$ ton Brown Paper at 30s. cwt.

„ 11. E. James paid his account to 30th June, less $2\frac{1}{2}$% discount. E. James returned 1 cwt. Brown Paper damaged, purchased on 10th July, at 16s. cwt.

„ 12. Yoland & Co. requested permission to retire bill due to-day and in consideration give cheque for £100 (which they enclosed) and a two months bill for the balance, plus 5% interest per annum, which was agreed to.

„ 14. Received £69 10s. from F. Harris & Sons, being amount of debt written off as bad debt two years previously.

„ 15. Drew cheque for Petty Cash, £40.

July 17. Transferred to current account from deposit account, £500, and paid Westwood & Co.'s account, less 3¾% discount.
Bill Payable due this day met.

„ 18. Received Cash from A. Bell in settlement of account to date.
Purchased new roll top desk for office, £35, payment being made by cheque.

„ 20. Sold to Yoland & Co. :—
½ ton Bank Paper, part of purchase of 7th inst., at 6s 3d. ream.
100 gross of Ivory Boards, 25 lbs. to gross, at 8d. lb.

„ 22. Purchased of Westwood & Co. :—
1 ton each of Azure-laid and Cream-laid Paper in various weights, at an average price £5 cwt.
Drew cheque for Petty Cash, £35.

„ 24. Returned to Westwood & Co. 4 cwt. of the Azure-laid Paper and debited their account; also debited their account for 1 cwt. of Cream-laid Paper, only 19 cwt. having been received of the ton ordered and invoiced to us (see entry 22nd July).

„ 25. Received notice of E. James' bankruptcy and to the effect that there would be no dividend for unsecured creditors.

„ 26. Sold as agents at 15% commission on behalf of Westwood & Co. to Yoland & Co. goods value £450. The goods were sent direct to Yoland & Co. from Westwood & Co., with the invoice, payment to be made to Westwood & Co.

„ 29. Drew cheques, Petty Cash, £40.
S. Baldwin, Drawings, £40.
N. Cook, do. £30.

Sundry payments out of Petty Cash :—

	£	s.	d.
Wages	65	10	0
Telephone account	5	14	6
Trade expenses	24	4	6
Stationery, etc.	13	11	0

TRANSFER JOURNAL

Dr. | *Cr.*

Sales Ledger.	Purchases Ledger.	General Ledger.	Fo.	Date.		Fo.	Sales Ledger.	Purchases Ledger.	General Ledger.
£ s. d.	£ s. d.	£ s. d.		19..			£ s. d.	£ s. d.	£ s. d.
				July 1	Sundries . . . *Dr.*				
					To Sundries—				
		1,000 0 0	G.L. 6		Cash on Deposit . . .		Adjustment Account, 534 10 6		
		236 7 9	G.L. 5		Cash at Bank . . .				
		534 10 6	G.L. 10		Sundry Debtors . . .	S.L. 4			
145 10 0			S.L. 1		E. James				
234 9 0			S.L. 2		Yoland & Co. . . .				
154 11 6			S.L. 3		A. Bell				
		293 0 0	G.L. 12		Bills Receivable . . .				
					M. Yoland & Co., due 12th July . . .				
		1,060 17 11	G.L. 7		Stock in Trade . . .				
	Adjustment Account, 503 15 0	203 0 0	G.L. 8		Furniture and Fittings . .				
		500 0 0	G.L. 9		Freehold Premises . .				
			P.L. 3		Sundry Creditors . .	G.L. 11			503 15 0
					Cant & Son . . .	P.L. 1		179 14 7	
					Westwood & Co. . .	P.L. 2		324 0 5	
					Bills Payable . . .	G.L. 13			824 1 2
					Cant & Son . . .				
					£ s. d.				
					due 17 July 420 0 0				
					due 18 Aug. 404 1 2				
					Capital Accounts—				
					S. Baldwin . . .	G.L. 1			1,500 0 0
					H. Cook . . .	G.L. 3			1,000 0 0
					Being opening balances at this date.				
£534 10 6	£503 15 0	£3,827 16 2					£534 10 6	£503 15 0	£3,827 16 2

Dr. TRANSFER JOURNAL—(*Continued*). *Cr.*

293 0 0			S.L. 2	July 12	Yoland & Co. . . *Dr.* To Bills Receivable . . *Being retirement of bill due this date.*	G.L. 12			293 0 0
1 12 2			S.L. 2	July 12	Yoland & Co. . . *Dr.* To Interest Account . . *Being 2 months' interest at 5% p.a. on £193.*	G.L. 15			1 12 2
		194 12 2	G.L. 12	July 12	Bills Receivable . . *Dr.* To Yoland & Co. . . *Being amount of renewed bill due 12th Sept.*	S.L. 2	194 12 2		
		66 4 0	G.L. 18	July 25	Bad Debts Account . *Dr.* To E. James . . . *Being amount of debt irrecoverable written off.*	S.L. 1	66 4 0		
	67 10 0		P.L. 2	July 26	Westwood & Co. . . *Dr.* To Commission Account . *Being amount of commission at 15% on £450 goods sold to Yoland & Co.*	G.L. 16			67 10 0
£294 12 2	£67 10 0	£260 16 2					£260 16 2		£362 2 2
Dr. G.L. Fo. 10. *Cr.* S.L. Fo. 4.	*Dr.* G.L. Fo. 11. *Cr.* P.L. Fo. 3.						*Dr.* S.L. Fo. 4. *Cr.* G.L. Fo. 10		

CASH RECEIVED BOOK.

Date.		Fo.	Discount.	Bank.	Sales Ledger.	Purchases Ledger.	General Ledger.
			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
19.. July 4	To A. Bell	S.L. 3		154 11 6	154 11 6	This column is rarely used, but is provided for use as and when required.	
„ 11	„ E. James	S.L. 1	3 12 9	141 17 3	145 10 0		
„ 12	„ M. Yoland & Co.	S.L. 2		100 0 0	100 0 0		
„ 14	„ Bad Debts Recovered Account—F. Harris & Sons	G.L. 17		69 10 0			69 10 0
„ 17	„ Deposit Account	G.L. 6		500 0 0			500 0 0
„ 18	„ A. Bell	S.L. 3		12 11 6	12 11 6		
			£3 12 9	£978 10 3	£412 13 0		£569 10 0
	Note.—Details are posted to the credit of accounts stated. Totals posted as marked.		Dr. G.L. Fo. 14.	Dr. G L. Fo. 8.	Dr. S.L. Fo. 4. Cr. G.L. Fo. 10.		✓

Note.—When the Cash Book is divided into two separate books for receipts and payments, the latter books occupy their true position as subsidiary books or journals, while the Bank Account in the General Ledger is shown in its true character as a ledger account.

CASH PAID BOOK.

Date.		Fo.	Discount.	Bank.	Sales Ledger.	Purchases Ledger.	General Ledger.
19..			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
July 3	By Petty Cash	P.C.B		35 0 0	This column is rarely required, but it is provided for use should occasion necessitate.		35 0 0
„ 8	„ Cant & Son	P.L. 1	6 14 10	172 19 9		179 14 7	
„ 15	„ Petty Cash	P.C.B		40 0 0			40 0 0
„ 17	„ Bill Payable— Cant & Son	G.L. 13		420 0 0			420 0 0
„ 17	„ Westwood & Co.	P.L. 2	12 3 0	311 17 5		324 0 5	
„ 18	„ Furniture and Fittings—Roll Top Desk	G.L. 8		35 0 0			35 0 0
„ 22	„ Petty Cash	P.C.B		35 0 0			35 0 0
„ 29	„ Petty Cash	P.C.B		40 0 0			40 0 0
„ 29	„ S. Baldwin, Drawings	G.L. 2		40 0 0			40 0 0
, 29	„ H. Cook, Drawings	G.L. 4		30 0 0			30 0 0
			£18 17 10	£1,159 17 2		£503 15 0	£675 0 0
	NOTE.—Details are posted to the debit of accounts stated and the totals as marked.		Cr. G.L. Fo. 14.	Cr. G.L. Fo. 5.		Dr. G.L. Fo. 11. Cr. P.L. Fo. 3.	√

Dr. PETTY CASH BOOK. *Cr.*

	Receipts.			Voucher No.	Payments.	Analysis. Wages.	Telephone.	Trade Expenses.	Stationery.
19..	£ s. d.	19..			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
July 3	35 0 0	July 29	By Wages		65 10 0	65 10 0			
„ 15	40 0 0	„ „	„ Telephone . . .		5 14 6		5 14 6		
„ 22	35 0 0	„ „	„ Sundry Trade Expenses .		24 4 6			24 4 6	
„ 29	40 0 0	„ „	„ Stationery, etc. . .		13 11 0				13 11 0
			To G.L. 25		109 0 0	£65 10 0	£5 14 6	£24 4 6	£13 11 0
		July 29	By Balance	*c/d.*	41 0 0				
To G.L. 25	£150 0 0				£150 0 0	G.L. Fo. 21.	G.L. Fo. 22.	G.L. Fo. 23.	G.L. Fo. 24.
July 31	41 0 0		To Balance	*b/d.*					

NOTE.—In practice, of course, each individual payment will be the subject of a separate entry. The summary shown above is intended to illustrate the manner in which the book is usually kept. A more detailed example is given on page 76.

SALES DAY BOOK.

			£ s. d.	£ s. d.
19.. July 3	M. Yoland & Co. :— 14 reams Azure-laid Paper, 30 lbs. per ream=420 lbs. @ 9d. lb.		15 15 0	
	5 reams Cream-laid Paper, 21 lbs. per ream=105 lbs. @ 10d. lb.		4 7 6	
		S.L. 2		20 2 6
„ 4	A. Bell :— 4 cwt. Brown Paper @ 16/6 cwt.		3 6 0	
	7 cwt. Brown Paper @ 26/6 cwt.		9 5 6	
		S.L. 3		12 11 6
„ 8	E. James :— 1 ton Tissue Paper, 7 lbs. per ream=320 reams @ 3/- ream .		48 0 0	
		S.L. 1		48 0 0
„ 10	E. James :— 5 cwt. Brown Paper @ 16/- cwt.		4 0 0	
	10 cwt. Brown Paper @ 30/- cwt.		15 0 0	
		S.L. 1		19 0 0
„ 20	M. Yoland & Co. :— 10 cwt. Bank Paper, 10 lbs. to ream of 480 sheets =112 reams @ 6/3 ream .		35 0 0	
	100 gross Ivory Boards, 35 lbs. to gross=3500 lbs. @ 8d. lb.		116 13 4	
		S.L. 2		151 13 4
	Total credited to Adjustment Account, Fo. S.L. 4			£251 7 4

General Ledger.
Total debited to Sundry Debtors, Fo. 10, and credited to Sales Account, Fo. 20.

SALES RETURNS BOOK.

			£ s. d.	£ s. d.
19.. July 11	E. James :— Returns— 1 cwt. Brown Paper, damaged, @ 16/- cwt. . . .		16 0	
		S.L. 1		16 0
	Total debited to Adjustment Account, Fo. S.L. 4			16 0

General Ledger.
Total debited to Sales Account, Fo. 20, and credited to Sundry Debtors, Fo. 10.

SALES LEDGER

Folio 1

Dr. E. JAMES. *Cr.*

			£	s.	d.				£	s.	d.
19 .						19..					
July 1	To Balance .	J.	145	10	0	July 11	By Cash . .	C.R.B.	141	17	3
„ 8	„ Goods .	S.D.B.	48	0	0	„ 11	„ Discount .	„	3	12	9
„ 10	„ „ . .	S.D.B.	19	0	0	„ 25	„ Returns .	S.R.B.		16	0
						„ 31	„ Bad Debts .	T.J.	66	4	0
			£212	10	0				£212	10	0

Folio. 2.

Dr. M. YOLAND & CO. *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
July 1	To Balance .	J.	234	9	0	July 12	By Cash . .	C.R.B.	100	0	0
„ 3	„ Goods . .	S.D.B.	20	2	6	„ 12	„ Bill Receivable .	T.J.	194	12	2
„ 12	„ Bill Retired .	T.J.	293	0	0	„ 31	„ Balance .	c/d.	406	4	10
„ 12	„ Interest .	T.J.	1	12	2						
„ 20	„ Goods . .	S.D.B.	151	13	4						
			£700	17	0				£700	17	0
July 31	To Balance .	b/d.	406	4	10						

Folio 3.

Dr. A. BELL. *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
July 1	To Balance .	J.	154	11	6	July 4	By Cash . .	C.R.B.	154	11	6
„ 4	„ Goods . .	S.D.B.	12	11	6	„ 18	„ „ . .	C.R.B.	12	11	6
			£167	3	0				£167	3	0

Folio 4.

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT. *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
July 31	To Returns .	S.R.B.		16	0	July 1	By Balance .	J.	534	10	6
„ 31	„ Cash and Discount .	C.R.B.	412	13	0	„ 31	„ Sales . .	S.D.B.	251	7	4
„ 31	„ Bills Receivable . .	T.J.	194	12	2	„ 31	„ Bills Receivable Retired	T.J.	293	0	0
„ 31	„ Bad Debts	T.J.	66	4	0	„ 31	„ Interest .	T.J.	1	12	2
„ 31	„ Balance .	c/d.	406	4	10						
			£1,080	10	0				£1,080	10	0
						July 31	By Balance .	b/d.	406	4	10

PURCHASES BOOK.

			£ s. d.	£ s. d.
19.. July 7	Cant & Son— 20 cwt. Bank Paper, 10 lbs. to ream of 480 sheets= 2,240 lbs. @ 5d. lb. . .		46 13 4	
		P.L. 1		46 13 4
July 8	Cant & Son— 1 ton Tissue Paper . . .		32 0 0	
		P.L. 1		32 0 0
July 22	Westwood & Co.— . . . 20 cwt. Azure-laid Paper, 20 cwt. Cream-laid Paper, — 40 cwt. various weights at average of £5 cwt.		200 0 0	
		P.L. 2		200 0 0
	Total debited to Adjustment Account, Fo. P.L. 3			£278 13 4

General Ledger.

Total debited to Purchases Account, Fo. 19,
and credited to Sundry Creditors, Fo. 11.

PURCHASES RETURNS BOOK.

			£ s. d.	£ s. d.
19.. July 24	Westwood & Co.— 4 cwt. Azure-laid Paper returned @ £5 cwt.		20 0 0	
	1 cwt. Cream-laid Paper, short delivered, @ £5 cwt. . .		5 0 0	
		P.L. 2		25 0 0
	Total credited to Adjustment Account, Fo. P.L. 3			£25 0 0

General Ledger.

Total debited to Sundry Creditors, Fo. 11,
and credited to Purchases Account, Fo. 19.

PURCHASES LEDGER

Folio 1.

Dr. CANT & SON. *Cr.*

			£ s. d.				£ s. d.
19.. July 8	To Cash and Discount .	C.P.B.	179 14 7	19.. July 1	By Balance .	J.	179 14 7
				„ 7	„ Goods .	P.B.	46 13 4
„ 31	„ Balance .	*c/d.*	78 13 4	„ 8	„ „	P.B.	32 0 0
			£258 7 11				£258 7 11
				July 31	By Balance .	*b/d.*	78 13 4

Folio 2.

Dr. WESTWOOD & CO. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
July 17	To Cash and Discount .	C.P.B.	324 0 5	July 1	By Balance .	J.	324 0 5
„ 24	„ Returns .	P.R.B.	25 0 0	„ 22	„ Goods .	P.B.	200 0 0
„ 26	„ Commission .	T.J.	67 10 0				
„ 31	„ Balance .	*c/d.*	107 10 0				
			£524 0 5				£524 0 5
				July 31	By Balance .	*b/d.*	107 10 0

Folio 3.

Dr. GENERAL LEDGER ADJUSTMENT ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
July 1	To Balance .	J.	503 15 0	July 31	By Returns .	P.R.B.	25 0 0
„ 31	„ Purchases .	P.B.	278 13 4	„ 31	„ Cash and Discount .	C.P.B.	503 15 0
				„ 31	„ Commission	T.J.	67 10 0
				„ 31	„ Balance .	*c/d.*	186 3 4
			£782 8 4				£782 8 4
July 31	To Balance .	*b/d.*	186 3 4				

GENERAL LEDGER

Folio 1.

Dr. S. BALDWIN, CAPITAL ACCOUNT. *Cr.*

							£ s. d.
				19..			
				July 1	By Balance .	J.	1,500 0 0

Folio 2.

Dr. S. BALDWIN, DRAWINGS ACCOUNT. *Cr.*

			£ s. d.				
19..							
July 29	To Cash . .	C.P.B.	40 0 0				

Folio 3.

Dr. H. COOK, CAPITAL ACCOUNT. *Cr.*

							£ s. d.
				19..			
				July 1	By Balance .	J.	1,000 0 0

Folio 4.

Dr. H. COOK, DRAWINGS ACCOUNT. *Cr.*

			£ s. d.				
19.. July 29	To Cash .	C.P.B.	30 0 0				

Folio 5.

Dr. BANK CURRENT ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19.. July 1	To Balance .	J.	236 7 9	19.. July 31	By Sundries .	C.P.B.	1,159 17 2
" 31	" Sundries .	C.R.B.	978 10 3	" 31	" Balance .	*c/d.*	55 0 10
			£1,214 18 0				£1,214 18 0
July 31	To Balance .	*b/d.*	55 0 10				

Folio 6.

Dr. BANK DEPOSIT ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19.. July 1	To Balance .	J.	1,000 0 0	19.. July 17	By Current Account .	C.R.B.	500 0 0
				" 31	" Balance .	*c/d.*	500 0 0
			£1,000 0 0				£1,000 0 0
July 31	To Balance .	*b/d.*	500 0 0				

Folio 7.

Dr. STOCK-IN-TRADE. *Cr.*

			£ s. d.				
19.. July 1	To Balance .	J.	1,060 17 11				

Folio 8.

Dr. FURNITURE AND FITTINGS. *Cr.*

			£ s. d.				
19.. July 1	To Balance .	J.	203 0 0				
" 18	" Roll Top Desk	C.P.B.	35 0 0				

Folio 9.

Dr. FREEHOLD PREMISES. *Cr*

			£ s. d.				
19.. July 1	To Balance	J.	500 0 0				

Folio 10.

Dr. SUNDRY DEBTORS. *Cr.*

(*or Sales Ledger Adjustment Account*).

			£	s.	d.				£	s.	d.
19..						19..					
July 1	To Balance .	J.	534	10	6	July 31	By Returns .	G.L.20		16	0
„ 31	„ Sales, per S.D.B. .	G.L.20	251	7	4	„ 31	„ Cash and Discount .	C.R.B.	412	13	0
„ 31	„ Bills Receivable Retired .	T.J.	293	0	0	„ 31	„ Bills Receivable .	T.J.	194	12	2
„ 31	„ Interest .	T.J.	1	12	2	„ 31	„ Bad Debts .	T.J.	66	4	0
						„ 31	„ Balance .	*c/d.*	406	4	10
			£1,080	10	0				£1,080	10	0
July 31	To Balance .	*b/d.*	406	4	10						

Folio 11.

Dr. SUNDRY CREDITORS. *Cr.*

(*or Purchases Ledger Adjustment Account*).

			£	s.	d.				£	s.	d.
19..						19..					
July 31	To Returns .	G.L.19	25	0	0	July 1	By Balance .	J.	503	15	0
„ 31	„ Cash and Discount .	C.P.B.	503	15	0	„ 31	„ Purchases, per P.D.B. .	G.L.19	278	13	4
„ 31	„ Commission .	T.J.	67	10	0						
„ 31	„ Balance .	*c/d.*	186	3	4						
			£782	8	4				£782	8	4
						July 31	By Balance .	*b/d.*	186	3	4

Folio 12.

Dr. BILLS RECEIVABLE. *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
July 1	To Balance .	J.	293	0	0	July 12	By Yoland & Co.	T.J.	293	0	0
„ 12	To Yoland & Co.	T.J.	194	12	2						

Folio 13.

Dr. BILLS PAYABLE. *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
July 17	To Cash . .	C.P.B.	420	0	0	July 1	By Balance .	J.	824	1	2
„ 31	„ Balance .	*c/d.*	404	1	2						
			£824	1	2				£824	1	2
						July 31	By Balance .	*b/d.*	404	1	2

Folio 14.

Dr. DISCOUNT. *Cr.*

			£	s.	d.				£	s.	d.
19..						19..					
July 31	To Sundries .	C.R.B.	3	12	9	July 31	By Sundries .	C.P.B.	18	17	10

Folio 15.

Dr. INTEREST. *Cr.*

				19.. July 12	By Sundries .	T.J.	£ s. d. 1 12 2

Folio 16.

Dr. COMMISSION. *Cr.*

				19.. July 26	By Westwood & Co. . .	T.J.	£ s. d. 67 10 0

Folio 17.

Dr. BAD DEBTS RECOVERED. *Cr.*

				19.. July 14	By Cash— T. Harris .	C.R.B.	£ s. d. 69 10 0

Folio 18.

Dr. BAD DEBTS. *Cr.*

19.. July 25	To E. James .	T.J.	£ s. d. 66 4 0				

Folio 19.

Dr. PURCHASES. *Cr.*

19..			£ s. d.	19..			£ s. d.
July 31	To Sundries, per P.D.B. .	G.L.11	278 13 4	July 31	By Returns .	G.L.11	25 0 0
				„ 31	„ Balance .	*c/d.*	253 13 4
			£278 13 4				£278 13 4
July 31	To Balance .	*b/d.*	253 13 4				

Folio 20.

Dr. SALES. *Cr.*

19..			£ s. d.	19..			£ s. d.
July 31	To Returns .	G.L.10	16 0	July 31	By Sundries, per S.D.B. .	G.L.10	251 7 4
„ 31	„ Balance .	*c/d.*	250 11 4				
			£251 7 4				£251 7 4
				July 31	By Balance .	*b/d.*	250 11 4

Folio 21.

Dr. WAGES. **Cr.**

19.. July 31	To Petty Cash .	P.C.B.	£ s. d. 65 10 0				

Folio 22.

Dr. TELEPHONE. **Cr.**

19.. July 31	To Petty Cash .	P.C.B.	£ s. d. 5 14 6				

Folio 23.

Dr. TRADE EXPENSES. **Cr.**

19.. July 31	To Petty Cash .	P.C.B.	£ s. d. 24 4 6				

Folio 24.

Dr. STATIONERY. **Cr.**

19.. July 31	To Petty Cash .	P.C.B.	£ s. d. 13 11 0				

Folio 25.

Dr. PETTY CASH. *Cr.*

19..			£ s. d.	19..			£ s. d.
July 31	To Sundries .	P.C.B.	150 0 0	July 31	By Sundries .	P.C.B.	109 0 0
				,, 31	,, Balance .	*c/d.*	41 0 0
			£150 0 0				£150 0 0
July 31	To Balance .	*b/d.*	41 0 0				

TRIAL BALANCE—SALES LEDGER—31st JULY, 19...

S.L.			£ s. d.	£ s. d.
2	M. Yoland & Co.		406 4 10	
4	General Ledger Adjustment Account .			406 4 10
			£406 4 10	£406 4 10

TRIAL BALANCE—PURCHASES LEDGER—31st JULY, 19...

P.L.			£ s. d.	£ s. d.
1	Cant & Son			78 13 4
2	Westwood & Co.			107 10 0
3	General Ledger Adjustment Account .		186 3 4	
			£186 3 4	£186 3 4

TRIAL BALANCE—GENERAL LEDGER—31ST JULY, 19..

G.L.		£	s.	d.	£	s.	d.
1	S. Baldwin, Capital				1,500	0	0
2	„ Drawings	40	0	0			
3	H. Cook, Capital				1,000	0	0
4	„ Drawings	30	0	0			
5	Bank Current Account	55	0	10			
6	Bank Deposit Account	500	0	0			
7	Stock-in-Trade	1,060	17	11			
8	Furniture and Fittings	238	0	0			
9	Freehold Premises	500	0	0			
10	Sundry Debtors	406	4	10			
11	Sundry Creditors				186	3	4
12	Bills Receivable	194	12	2			
13	Bills Payable				404	1	2
14	Discount Account				15	5	1
15	Interest Account				1	12	2
16	Commission Account				67	10	0
17	Bad Debts Recovered				69	10	0
18	Bad Debts	66	4	0			
19	Purchases	253	13	4			
20	Sales				250	11	4
21	Wages	65	10	0			
22	Telephone	5	14	6			
23	Trade Expenses	24	4	6			
24	Stationery	13	11	0			
25	Petty Cash	41	0	0			
		£3,494	13	1	£3,494	13	1

If it is decided to adopt the method suggested on page 434, and to omit the adjustment accounts from the back of each ledger and to include them as memorandum accounts only in the general ledger, the procedure will be somewhat similar but in a reverse manner. Take, for example, the "General Ledger Adjustment Account" in the purchases ledger as shown on page 452. The balance of £503 15s. on 1st July consists of credit balances in the purchases ledger, i.e., amounts owing to creditors, but is shown on the opposite side of the ledger "in order to make the ledger self-balancing." Under the method now suggested this item will appear on the same side in the adjustment account in the general ledger as that on which the balances appear in the personal accounts in the purchases ledger, i.e., the credit side.

Next, the purchases which have been *credited* in detail to the personal accounts in the purchases ledger will be *credited* also, but in total, to the adjustment account in the general ledger. In the same way, the returns, cash, discount, and commission which have been *debited* to the personal accounts will be *debited* to the adjustment account; the balance of the account when carried down will be the total of the sundry credit balances in the ledger.

The same method will be adopted with the sales ledger items, and the general ledger will then contain, in addition to, but quite apart from, its own balances, two memorandum accounts headed "Sales Ledger Adjustment Account" and "Purchases Ledger Adjustment Account." These accounts are practically "Total Debtors" and "Total Creditors" accounts, and in addition to being used for checking the ledger balances submitted by the ledger clerks at balancing time, they can be used in conjunction with the general ledger balances for drawing up interim accounts at any time without the extraction of the personal ledger balances. It will be seen, therefore, that although this method does not involve as much work as the one previously illustrated, all the essentials are given devoid of unnecessary complications and the whole object of "self-balancing" ledgers is achieved.

When there are several purchases and sales ledgers it is sometimes found more convenient to keep special summary books for the adjustment accounts. A specimen of a sales ledger summary book is given below.

This method of treatment, when properly organised, lends itself to far more effective supervision and a more complete internal check than the method previously illustrated. The general ledger containing the adjustment accounts, or the summary books, can be kept by the chief accountant who will compile the accounts from the books of original entry. Each ledger clerk is required to submit a list of the balances in his ledger to the chief accountant periodically, and the net total must agree with the figures shown in the general ledger or the summary book for that particular ledger. As the ledger clerk has no access to the general ledger adjustment accounts or the summary book the risk of fraudulent manipulation is very slight. The summary book may be in the following form :—

Dr. SALES LEDGERS SUMMARY BOOK. *Cr.*

Date.	Particulars.	A–F	G–O	P–Z	Total.	Date.	Particulars.	A–F	G–O	P–Z	Total.
19..		£ s. d.	£ s. d.	£ s. d.	£ s. d.	19..		£ s. d.	£ s. d.	£ s. d.	£ s. d.

An alternative form for this book, which is sometimes considered to be more convenient, is given on the following page.

SALES LEDGERS SUMMARY BOOK.

	Transaction.	Source of Information.	A to F. Debits.	A to F. Credits.	G to O. Debits.	G to O. Credits.	P to Z. Debits.	P to Z. Credits.	Total. Debits.	Total. Credits.
19..			£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Jan. 1	To Balances	*b/d.*	7,621 5 0		6,485 10 0		8,426 7 0		22,533 2 0	
„ 31	„ Sales	Sales Day Book	8,726 10 0		7,250 12 6		9,261 10 6		25,238 13 0	
„ 31	„ Dishonoured Cheques	Cash Book	51 10 0				26 0 0		77 10 0	
„ 31	„ Dishonoured or Renewed Bills	Cash Book or Transfer Journal	125 0 0		161 0 0				286 0 0	
„ 31	„ Interest Charges	Transfer Journal	1 12 6		4 5 6				5 18 0	
„ 31	„ Cash Payments	Cash Book	10 6 0				21 10 0		31 16 0	
„ 31	„ Other Charges	Journal (usually)								
A „ 31	„ Transfers	Transfer Journal	62 10 0		51 6 6		25 12 6		139 9 0	
„ 31	By Returns	Sales Returns Book		126 10 6		105 15 0		78 12 6		310 18 0
B „ 31	„ Cash and Discount	Cash Book		6,250 10 0		6,512 12 6		7,630 15 0		20,393 17 6
„ 31	„ Bills Receivable	Bill Book		1,526 10 0		821 10 6		1,725 6 6		4,073 7 0
„ 31	„ Allowances	Credit Journal or Transfer Journal		15 10 6						15 10 6
„ 31	„ Bad Debts	Transfer Journal		61 10 0						61 10 0
A „ 31	„ Transfers	Transfer Journal		51 0 0		28 15 0		41 6 8		121 1 8
„ 31	„ Balances	*c/d.*		8,567 2 6		6,484 1 6		8,284 19 4		23,336 3 4
			£16,598 13 6	£16,598 13 6	£13,952 14 6	£13,952 14 6	£17,761 0 0	£17,761 0 0	£48,312 8 0	£48,312 8 0
Jan. 31	To Balances	*b/d.*	8,567 2 6		6,484 1 6		8,284 19 4		23,336 3 4	

NOTE.—A. These items include transfers to or from the purchases ledger, as, for example, where goods are sold and bought from the same person. When a settlement is effected either by payment or receipt of cash, an entry is passed through the Transfer Journal. In practice, one amount only is recorded from the Transfer Journal for the debits, and one for the credits. The details shown above are designed as a guide to students of the nature of the entries.

B. A combined total is shown of these figures from the analysis columns of the Cash Paid and Cash Received Books.

Sectional Balancing.

In view of the fact that questions are sometimes asked on "Sectional" balancing, it may be mentioned here that this is also a method of self-balancing, but instead of each of the ledgers being balanced individually, they are balanced in groups of two or three ledgers each, according to circumstances. If an error occurs it can only be traced to its group and not to any particular ledger in the group, and it is necessary then to check all the ledgers in the group to find the error. Only in very special circumstances is this method adopted, and as it has no outstanding advantages the student need not give it further attention than to remember the distinction between pure "self-balancing" and "sectional" balancing.

It must also be mentioned, however, that the terms "self-balancing" and "sectional balancing" are sometimes used synonymously, and as there is no definite ruling on the point, the student must be guided by the context in answering a question dealing with the matter.

DEPARTMENTAL ACCOUNTS

Where a large business consists of several different departments it is usually desired to ascertain the trading results achieved by each department, especially where they are under separate management.

Departmental accounts may be broadly divided into two classes :—

(1) Those from which it is desired to ascertain the departmental gross profits only.
(2) Those from which it is desired to ascertain the departmental net profits as well as the departmental gross profits.

In both instances it is customary for the Purchases and Sales Journals, Returns Books, etc., to be in columnar form with additional columns for each department, as illustrated in Chapter II., pages 39 and 47. The Wages Book must similarly be made out in columnar form and, of course, it is necessary to take stock separately for each department. Separate accounts may be opened in the general ledger for sales, purchases, wages, etc., to which the periodical totals of these items are posted. Alternatively, the general ledger itself may be provided with extra columns to record separately the figures applicable to each department. Examples of these columnar impersonal ledger accounts are shown on the following page.

Dr. SALES. *Cr.*

Date.		Fo.	A.	B.	Total.	Date.		Fo.	A.	B.	Total.
19..		S.R.B.	£	£	£	19..		S.D.B.	£	£	£
Jan. 31	To Sundries .	5	51	12	63	Jan. 31	By Sundries .	21	520	258	778
Feb. 28	" " .	10	25		25	Feb. 28	" " .	51	455	136	591

Dr. WAGES. *Cr.*

Date.		Fo.	A.	B.	Total.	Date.		Fo.	A.	B.	Total
19..		C.B.	£	£	£	19..			£	£	£
Jan. 5	To Cash . .	3	85	33	118						
" 12	" " . .	11	85	33	118						

Goods transferred from one department to another should not be merged in the purchases and sales of the departments concerned, but should be recorded in special accounts and shown separately on both the debit and credit sides of the departmental Trading Account.

When it is desired to ascertain the net profit for each department, it is also necessary to dissect the various items of gain and expenditure which are credited and debited to the Profit and Loss Account. If the exact amount of expenditure for each department is known, a columnar ledger will conveniently record the desired information. In many cases, however, the exact figures of the expenditure for each department are not available, and it is sometimes difficult to determine the most accurate and equitable method of apportioning the expenditure on the fixed overhead charges. More usually, the apportionment is made either upon an arbitrary basis (e.g., one-half to department A and one-fourth each to departments B and C) or upon a percentage basis, varying year by year with the total sales. In the latter instance, assuming the total turnover to be £100,000 and the separate amounts for departments A and B to be £60,000 and £40,000 respectively, the percentage basis for department A will be 60 per cent. and for department B 40 per cent. But either of these methods may be inequitable in certain circumstances, and each case should be considered on its own merits before the method of apportionment is adopted. For example, it may be more equitable to apportion the charge for rent and rates on the basis of the floor space occupied, while fire insurance may be fairly apportioned on the average value of the stock of each department. Apportionment on the basis of turnover may be effected in the case of direct selling expenses, e.g., travellers' expenses.

Such departmental accounts as are considered here are best shown in columnar form (as illustrated in the example shown on page 463) with the various items of expenditure for each department, and the totals, side by side. A comparison of

the departmental figures may easily be made if the accounts are prepared on this principle, and, to carry the comparison still further, the percentages which the gross and net profit bear to the turnover may also be shown.

In exceptional cases, each department is conducted as though it were a distinct business and, accordingly, it has its own sales, purchases and impersonal ledgers, in which are recorded all transactions which relate specifically to it as a department. At the end of the trading period, stocktaking is carried out on a departmental basis, and separate Trading and Profit and Loss Accounts are compiled, the final figures being combined and transferred to the private ledger.

This method, however, involves a certain amount of duplication of clerical work in keeping separate personal ledgers, as a customer of one department is probably a customer of other departments; and the same duplication will occur with the purchases ledgers. It is much more convenient to have the whole of the transactions with one person or firm concentrated in one personal account and, therefore, the almost universal practice is for the sales and purchases of all departments to be recorded in one set of ledgers.

EXAMPLE.

The General Engineering Co., Ltd., of Birmingham, had two departments—(1) a Manufacturing Department, and (2) a Retail Department for the sale of general engineering sundries.

The capital of the company was £20,000, divided into 20,000 shares of £1 each, all issued, and all fully paid.

The following were the balances standing in the books of the company at 31st December. Prepare therefrom Trading Accounts of the two departments, and Profit and Loss Account for the year ended the 31st December, 19.., showing the percentages which the gross and net profits bear to the turnover of each department and the total, together with Balance Sheet at that date :—

		£
Capital		20,000
Machinery and Plant at 1st January (as per valuation)		4,000
Stock in Trade (Retail), at 1st January		5,000
Do (Works), do		6,000
Sundry Debtors		4,450
Sundry Creditors		1,500
Rents, Rates and Insurance (Works)		480
Purchases	(do.)	8,000
Carriage and Freight (Inwards)	(do.)	500
Wages	(do.)	6,500
Office Salaries	(do.)	300
Office Expenses	(do.)	120
Sales	(do.)	19,800
Sales	(Retail)	35,000
Purchases	(do.)	28,000
Carriage Outwards	(do.)	1,000
Wages	(do.)	800
Office Salaries	(do.)	300
Office Expenses	(do.)	300
Rent, Rates and Insurance	(do.)	250

	£
Income Tax	350
Interest on Investments	150
Bank Interest, less Commission	200
Profit and Loss Account (Credit balance) . . .	1,200
Reserve Fund	5,000
Investments—Consols at cost	5,000
Cash in hand	150
Cash at Bank	9,800
Directors' Fees	1,550

The value of the Stock-in-Trade of the Retail Department, as taken and certified by the manager, was £5,200, and Works Department £6,150.

TRADING AND PROFIT AND LOSS ACCOUNTS.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

		Works Dept.	Retail Dept.	Total.			Works Dept.	Retail Dept.	Total.
		£	£	£			£	£	£
To Stock at 1st January		6,000	5,000	11,000	By Sales . . .		19,800	35,000	54,800
„ Purchases . .		8,000	28,000	36,000	„ Stock at 31st Dec. .		6,150	5,200	11,350
„ Wages . . .		6,500	800	7,300					
„ Carriage (Inwards) .		500		500					
„ Balance, being Gross Profit . . .	c/d.	4,950	6,400	11,350					
Percentage of Gross Profit to Turnover . .		*25·00%*	*18·29%*	*20·71%*					
		£25,950	£40,200	£66,150			£25,950	£40,200	£66,150
		£	£	£			£	£	£
To Carriage (Outwards) .			1,000	1,000	By Gross Profit . .	b/d.	4,950	6,400	11,350
„ Rent, Rates and Insurance . .		480	250	730					
„ Office Salaries . .		300	300	600					
„ Office Expenses .		120	300	420					
„ Balance . . .	c/d.	4,050	4,550	8,600					
Percentage of Net Profit to Turnover . .		*20·45%*	*13·00%*	*15·69%*					
		£4,950	£6,400	£11,350			£4,950	£6,400	£11,350

GENERAL PROFIT AND LOSS ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

		£			£	£
To Income Tax		350	By Balance :—	b/d.		
„ Directors' Fees . . .		1,550	Works Department . .		4,050	
„ Balance	c/d.	7,050	Retail „ . .		4,550	
						8,600
			„ Bank Interest (less Commission)			200
			„ Interest on Investments .			150
		£8,950				£8,950
		£				£
To Balance . . .	c/f	8,250	By Balance	b/d.		7,050
			„ Balance brought forward from previous year . . .			1,200
		£8,250				£8,250

THE GENERAL ENGINEERING CO., LTD.

BALANCE SHEET AS AT 31ST DECEMBER, 19..

Liabilities.	£ s. d.	£ s. d.	*Assets.*	£ s. d.	£ s. d.
Nominal Capital:—			Machinery and Plant as		
20,000 Shares of £1 each	£20,000 0 0		valued, 1st Jan., 19.. .		4,000 0 0
Issued and Paid-up Capital			Stock-in-Trade:—		
20,000 Shares of £1 each			Retail Dept. . .		5,200 0 0
fully paid . . .		20,000 0 0	Works . . .		6,150 0 0
Reserve Fund. . .		5,000 0 0	Sundry Debtors . .		4,450 0 0
Sundry Creditors .		1,500 0 0	Investments:—		
Profit and Loss Account .		8,250 0 0	Consols (at cost) . .		5,000 0 0
			Cash at Bank . . .	9,800 0 0	
			Cash in hand . .	150 0 0	
					9,950 0 0
		£34,750 0 0			£34,750 0 0

TABULAR BOOK-KEEPING

The term "Tabular Book-keeping" is sometimes loosely used to denote any form of book, either ledger or book of first entry, which is arranged in columnar form with additional money columns to facilitate the classification of the entries recorded therein. Strictly speaking, however, Columnar and Tabular systems of book-keeping are quite distinct; the term "columnar" referring to books of first entry such as columnar cash books. columnar day books, etc., while the term "tabular" is more correctly applied to a special form of ledger which also serves as an analytical day book.

The use of these tabular ledgers is restricted to those businesses the transactions of which involve detail of a fairly standardised nature. For example, the visitors' ledger of an hotel will normally contain entries for such "items" as bedrooms, meals, wines, cigars, baths, small disbursements for taxi fares, telephone calls, stamps, and sundries, as shown in the example on page 468. In the case of a local authority which levies rates or of a company which supplies gas, water, or electricity, the transactions are, of course, even more standardised, and an entry against each person's name in the column headed "Quarter ending........19..." is all that is required. The example referred to above and also those shown on pages 466 and 467 should be studied carefully in conjunction with the following explanation:—

It will be noted that in the case of tabular ledgers, several additional money columns are provided on each page, and, as the ledger also serves as an analytical day book, it records on the same page both the nominal and personal accounts, one class of account being kept horizontally and the other vertically. In the case of rental, rates and consumers' ledgers, a separate line is used for each person while a separate column is devoted to each class of transaction, but in the case of hotel ledgers it

is more convenient to show the personal accounts vertically in the columns provided, and to show each class of transaction horizontally.

In these classes of transactions the total number of personal accounts is so very considerable that a ledger constructed on the ordinary lines would be both cumbrous and inconvenient; on the other hand, tabular ledgers combine convenience with utility, and effect a considerable saving of clerical labour.

Tabular ledgers are, of course, ruled to accommodate both debit and credit entries as are personal ledgers, but while the latter are divided into pages to record the transactions with various persons—usually one person to a page—the basic principle of the tabular system is that the ledger is divided into pages or series of pages according to the date of, or the period covered by, the transactions. Thus, in the case of an hotel ledger, a certain page will record the transactions upon a specific date, while in the case of a rental, rates or consumers' ledger, a certain page is devoted to the transactions for a specific period.

According to the method employed, successive debit items are arranged side by side across the page, and their totals are shown in a total column at the extreme right of the page; while the successive credit items are arranged underneath each other with their totals at the foot of the page. Alternatively, this arrangement may be reversed.

It will be realised that, by reason of the horizontal additions (or "cross-casts") each page is self-checking, for the final total of the total column at the extreme right of the page must agree with the final cross-cast total of the individual vertical column totals. Any errors in addition are, therefore, easily located, and thus tabular ledgers are very easily balanced, notwithstanding that there may be several thousand accounts in one ledger. Other advantages which accrue under this system are—

(1) Many personal accounts are kept on the same page or folio.
(2) The accounts are easily kept up-to-date, and the position of any one personal account can be readily ascertained.
(3) A continuous and detailed analysis of the nominal accounts is automatically kept from day to day.

The examples of tabular ledgers which are given on pages 466 and 467 should be studied carefully, particular attention being devoted to the manner in which the equalising final total credit is made for the individual debits, and similarly, the equalising final total debit for the individual credits. Apart

QUARTERLY RENTAL LEDGER.

Ref. No.	Tenant.		Annual Rental.	Debits.			Date.	Credits.					Total Credits.
	Name.	Address.		Arrears Brought forward.	Rent due 25th Mar., 19...	Total amount due.		C.B. Fo.	Cash received.	Income Tax.	Allowances.	Arrears carried forward.	
				£	£	£	19..		£	£	£	£	£
			c/f.	£	£	£			£	£	£	£	£
				A	*B*	*C*			*D*	*E*	*F*	*G*	*H*

The totals are carried forward from page to page until the last page for the period is reached, when the final totals are posted to the appropriate accounts in the impersonal ledger.

A. The final total of this column represents the total outstanding debtors of the previous period.
B. The final total of this column is posted to the credit of Rents Receivable Account in the impersonal ledger.
C. This final total is the sum of the two preceding columns.
D. This final total must correspond with the total cash receipts recorded on the debit side of the Cash Book.
E. This final total is debited to Income Tax Account.
F. This final total may be debited to Allowances Account, or alternatively, to Rent Receivable Account. In some cases this column is subdivided into "Allowances for Repairs" and "Other Allowances."
G. The final total of this column represents the total outstanding debtors on closing the books for the period.
H. This final total is merely a "balancing" total. It is the aggregate of columns *D* to *G* and must, of course, correspond with the final total of "C" column.

Many forms of these tabular ledgers have additional "short" inset leaves to accommodate particulars relating to later periods; only columns *A* to *H* being repeated on the inset leaves, thus avoiding the necessity for rewriting the names and addresses on each leaf. A weekly rental ledger may have sufficient leaves to one opening to last three months, while a quarterly ledger would similarly last three years.

CONSUMERS' LEDGER FOR GAS COMPANIES.

For Quarter ended 25th March, 19...

Ref. No.	Name.	Address.	Debits.					Total Debits.	Date.	Credits.				Total Credits.
			Arrears brought forward.	Gas consumed.		Meter Rent.	Stove hire purchase.			C.B. Fo.	Cash received.	Allow-ances.	Arrears carried forward.	
				Qty.	Amount.									
			£		£	£	£	£	19..		£	£	£	£
			£		£	£	£	£			£	£	£	£
			A	*B*	*C*	*D*	*E*	*F*			*G*	*H*	*I*	*J*

The totals are carried forward from page to page until the last page for the period is reached.
Columns *A* and *I* represent respectively the outstanding debtors at the commencement and end of the period.

B. This column is provided for statistical purposes.
C. This final total is posted to the credit of Gas Consumed Account.
D. This final total is posted to the credit of Meter Rent Account.
E. This final total is posted to the credit of Stove Hire Purchase Account.
F. and *J*. These two columns are merely "balancing" columns and their final totals must, of course, be in agreement.
G. This final total must agree with the total cash receipts recorded in the Cash Book.
H. This final total is posted to the debit of Allowances Account.

from these examples, the basic principle of tabular ledgers is equally adaptable to the customers' ledgers of other commercial concerns such as laundries, bakers, dairymen, etc., where accounts are paid on regular fixed days.

It must be observed, however, that Tabular Book-keeping has its limitations, and its practical utility is confined to those businesses or undertakings the transactions of which are of a stereotyped nature and occur at fairly regular intervals. Where transactions are of an irregular nature, occurring at irregular intervals, or where it is essential to have a continuous record of each personal account, tabular ledgers are not suitable and the ordinary form of ledger is far more convenient.

Hotel Visitors' Ledgers.

It will be noted from the illustration of this ledger that the debits to the personal accounts occupy the upper portion of each page while the credits are shown in the lower portion. These books are often of an exceptional width, showing as many as 25 to 30 columns on a folio, and small hotels are able to record the whole of each day's transactions on one page. For larger hotels it is necessary to use additional pages, or, alternatively, to use separate ledgers for different series of rooms.

HOTEL VISITORS' LEDGER.

Monday, 1st January, 19..

Room No.	1	2	3	4	5	etc.		
DEBITS.	Visitor's Name.	Visitor's Name.	Visitor's Name.	Visitor's Name.	Visitor's Name.		DEBITS.	TOTAL.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.			£ s. d.
Balance b/f. Apartments Breakfasts Luncheons							*Balance b/f.* Apartments Breakfasts Luncheons	
Teas Dinners Suppers							Teas Dinners Suppers	
Wines Spirits Mineral Waters							Wines Spirits Mineral Waters	
Attendance Baths Fires							Attendance Baths Fires	
Laundry Sundries							Laundry Sundries	
Total	£	£	£	£	£		*Total*	£
CREDITS.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.		CREDITS	£ s. d.
Cash Received Allowances Ledger Account *Balance c/f*							Cash Received Allowances Ledger Account *Balance c/f.*	
	£	£	£	£	£			£

MONTHLY SUMMARY BOOK FOR HOTEL VISITORS' LEDGER.

	Apartments.	Breakfasts.	Luncheons.	Teas.	Dinners.	Suppers.	Wines.	Spirits.	Mineral Waters.	Attendance.	Baths.	Fires.	Laundry.	Sundries.	TOTAL.
19..	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Jan. 1															
" 2															
" 3															
" 4															
" 5															
etc.															
Monthly Total.	£	£	£	£	£	£	£	£	£	£	£	£	£	£	£

The entries in this book are abstracted daily from the Hotel Visitors' ledger, and, at the end of each month, the totals are credited to the appropriate accounts in the impersonal ledger. Usually, each page records the whole month's transactions and each page is self-balancing, the "cross-casts" of the totals at the foot of the vertical columns equalling the final total at the foot of the total column at the extreme right of the page. This book also acts as a convenient record for statistical purposes. The "credits" at the foot of the Visitors' Ledger may be summarised in a similar manner.

Where two or more pages are used for one day's transactions, the cross-cast totals must be carried forward from page to page in order that the total transactions of each class for the one day may be obtained. The ledger is written up daily and the balance carried forward each evening.

To arrive at convenient totals for posting to the accounts in the impersonal ledger the general practice is to use a Monthly Summary Book as illustrated above. An alternative procedure is to provide additional total columns at the extreme right-hand side of the page thus :—

DEBITS.	TOTALS.		
	Daily Total.	Total Brought Forward.	Total Carried Forward.
	£ s. d.	£ s. d.	£ s. d.
Balance b/d . . .			
Apartments, etc. . . .			

The credits at the foot of the page are dealt with in a similar manner. While this method may be suitable for small hotels, it has disadvantages in the case of large concerns because of the large number of cross casts and the unwieldy figures that become necessary.

A practical disadvantage of these large tabular ledgers is the tendency to enter amounts on the wrong line or in the wrong column. To overcome this difficulty, it is usual to introduce extra horizontal lines (in differently coloured ink) across the page to assist the eye when entering up the ledger.

It is customary for hotel bills to be settled weekly, hence the provision for "balances brought forward" at the top of each day's page and "balances carried forward" at the foot of the page. The accounts are usually cleared upon payment at the end of each week, but in some cases arrangements are made for a more extended period of credit, and the amounts owing are transferred to the debit of a personal account in the debtors' ledger.

Other Tabular Ledgers.

The Consumers' Ledgers of electric light and water companies and the Rate Ledgers of municipal authorities are arranged in a similar manner to the example of a Gas Consumers' Ledger illustrated on page 467. The material information to be recorded in these ledgers, however, necessarily differs. For example, in the case of electric light undertakings, electricity is supplied for two purposes, lighting and power, and differential rates are charged for these services. Similarly, water companies charge private householders on the basis of the annual rental value, but in the case of certain traders or manufacturers a meter is installed and the charge is based upon the quantity consumed. Again, Rate Ledgers have credit columns for such items as "Amounts legally excused" and "Irrecoverables." The former is used in cases where no rates are chargeable on empty houses, and the latter records the amounts not collected as a result of appeals or the poverty of ratepayers and losses from other causes.

The headings of the three ledgers above referred to may be summarised and compared as follows :—

ELECTRIC LIGHT COMPANIES.		WATER COMPANIES.		RATES.	
DEBITS.	CREDITS.	DEBITS.	CREDITS.	DEBITS.	CREDITS.
Ref. No. Name. Address. Consumption in B.T. Units. Price per Unit. Amount. Meter Rent. Rent of Fittings. Arrears *b/f.*	Date Paid. Amount received. Allowances. Arrears *c/f.*	Arrears *b/f.*	Date Paid. Amount received. Allowances.	Assessment No. Occupier. Owner. Description of Property and Situation. Gross Rental. Assessable Value. Amount assessed upon occupier. Amount assessed upon owner. Arrears *b/f.*	Date Paid. Amount Paid. Allowances to owner. Amount legally excused. Irrecoverables. Arrears *c/f.*
		Ref. No. Name. Address. Rateable Value. Amount due. Extra Services.	Date Paid. Amount received. Bad Debts. Allowances. Arrears *c/f.*		
TOTAL DEBITS.	TOTAL CREDITS.	TOTAL DEBITS.	TOTAL CREDITS.	TOTAL DEBITS.	TOTAL CREDITS.

These ledgers ordinarily contain several thousand names, and to avoid the necessity of rewriting the particulars each year, it is usually arranged that each page shall contain sufficient columns (or openings) for the book to last three or four years.

In addition to the headings above enumerated, tabular ledgers of gas, water and electric light companies often contain various statistical and other information. Rate Ledgers, for example, usually record the particulars for the municipal and parliamentary registers of voters. The detail work involved in the accounts of these bodies, however, is beyond the scope of this treatise and students desiring further information are advised to refer to a special manual on the subject. Summarised particulars of these special ledgers are given here simply to demonstrate the practical utility and advantages of tabular ledgers.

EXERCISE 11.

A. What do you understand by the term self-balancing ledgers? Explain their nature, and show their importance in a large trading concern.

B. In the case of a limited company having about 10,000 sales ledger accounts, state how it is possible to ascertain the total amount owing to the company (on these sales ledger accounts) without having to make a list of the balances.

Briefly outline the system which you would recommend.

C. Henry Walsh keeps his sales ledger upon the "self-balancing" principle. From the undermentioned particulars prepare the necessary "Sales Ledger Adjustment Account" as it would appear in the General Ledger on 31st January.

		£
Jan. 1.	Total debtors' debit balances at this date were .	12,542
Jan. 31.	Total goods sold to customers for the month .	21,658
	Total goods returned by customers for the month	942
	Total cash received from customers for the month	15,621
	Total discount allowed to customers for the month	968
	Total acceptances received from customers during the month	3,471
	Total acceptances dishonoured by customers during the month	542

D. From the following particulars write up A. Price's Bought Ledger for the month of November, and make it self-balancing. Prove the accuracy of your work by extracting a Trial Balance at the end of the month. The creditors as at 1st November were: W. James, £132 18s 2d.; M. Baker, £218 14s. 7d.; J. Cox, £92 19s. 5d.; M. Davies, £103 8s. 5d.; P. Edmunds, £73 19s. 5d.; S. Foster, £178 3s. 4d. Price's transactions for the month were as follows:—

			£	s.	d.
Nov.	1.	Bought of J. Cox, Goods	36	15	1
„	6.	Paid M. Davies (Discount £5 3s. 5d.) .	98	5	0
„	12.	Bought of W. James, Goods	123	14	7
„	13.	Paid to S. Foster on account	40	0	0
„	14.	Accepted W. James' Draft (Discount £4 0s. 5d.)	76	8	0

			£	s.	d.
Nov.	18.	Bought of M. Baker, Goods	32	17	4
„	19.	Returned Goods to P. Edmunds . .	13	15	3
„	20.	Paid P. Edmunds (Discount £3 0s. 2d.) .	57	3	11
„	24.	Bought of M. Davies, Goods . . .	63	13	5
„	„	Paid J. Cox (Discount £4 12s. 11d.) . .	88	6	6
„	„	Bought of P. Edmunds, Goods . . .	24	7	9
„	26.	Accepted S. Foster's Draft (Discount, £5 3s. 5d.)	98	4	6
„	29.	Paid M. Baker on account	50	0	0
„	„	Returned Goods to M. Baker . . .	18	7	7
„	„	Bought of S. Foster, Goods	82	19	5
„	30.	Paid W. James on account	25	0	0

E. In the business of X. Y. Z. & Co., the following books are in use: one Bought Ledger, two Sold Ledgers (Town and Country), one Private and Nominal Ledger, one Bank Cash Book, one Petty Cash Book, two Sales Books (Town and Country), one Purchases Book, and one Journal. Explain briefly what alterations (if any) it would be necessary to effect in these books in order to introduce the self-balancing ledger system.

F. S. Gormley is in business as a wholesale draper. His financial position on 1st January was as follows:—

Cash at bank, £512; Furniture and Fittings, £372; Stock on hand, £985; Debtor: R. Frank, £78; Creditor: A. Huntley, £308.

Open the necessary accounts in the Sales, Purchases, and General Ledgers to record the above particulars, and post thereto, through the proper subsidiary books, the following transactions:—

Jan. 2. Purchased, on credit, from G. Benton:—
 3 dozen wool scarves at 5s. 11d. each.
 1 gross beaded trimmings at 4s. 6d. per dozen.
 Less 10% trade discount.
„ 4. Returned, to G. Benton, 6 scarves as faded.
„ 6. Drew and cashed cheque and paid, in cash, salaries and wages, £32.
„ 6. Paid, by cheque, £200, on account to A. Huntley.
„ 6. Sold to A. Brown, 24 wool scarves at 7s. 6d. each.
„ 8. Purchased, from D. Jones, job lot of 20 velour costumes at two guineas each.
„ 10. Sold, on credit, to R. Frank, 50 costumes at £2 12s. 6d. each.
„ 13. Drew and cashed cheque and paid, in cash, office salaries, and wages, £34.
„ 14. Cash sales to date £87. Paid into Bank.
„ 16. Paid, by cheque to the London Packers, Ltd., packing materials, £49; and to the Midland Railway Co., railway carriage, £12 4s. 6d.
„ 17 R. Frank sent cheque in settlement of his December account, less 5% cash discount.
„ 20. Purchased, by cheque, new show-case, £75.
„ 22. Paid G. Benton the amount of his account, less 5% cash discount.
„ 22 A. Brown gave a 3 months Bill for the amount of his account.

Balance the Ledger and Cash Book, as on 22nd January, and extract a separate Trial Balance of each ledger.

NOTE:—No Profit and Loss Account or Balance Sheet is to be prepared.

G. A business is carried on in three separate departments. Expenses not directly chargeable to any department are apportioned, one-half to A, three-tenths to B, and one-fifth to C. From the following particulars prepare Trading and Profit and Loss Accounts of the three departments (in columnar form), showing the gross and net profits, and the percentages thereof and of the totals, to turnover, exclusive of inter-departmental transactions :—

Stocks on hand, 1st January,
A Department, £1,782 ; B, £560 ; C, £125.
Stocks on hand, 31st December,
A Department, £1,936 ; B, £471 ; C, £316.
Outside Sales for the year,
A Department, £11,174 ; B, £5,613 ; C, £4,851.
Inter-Departmental Sales,
A to B, £904 ; A to C, £482 ; B to A, £1,126 ; B to C, £219 ; C to A, £348.
Wages,
A Department, £2,740 ; B, £1,328 ; C, £915.
Outside Purchases,
A Department, £4,041 ; B, £1,537 ; C, £1,256.
Salaries,
A Department, £945 ; B, £572 ; C, £416.
Management Salaries, £1,200 ; Rent, Rates, and Taxes, £1,460 ; Insurance, £210 ; Horses, Vans, etc., Expenses, £870 ; Postages and Telegrams, £110 ; Bad Debts, A £276, B £143, C £224 ; Sundry Expenses, £530 ; Depreciations written off, £740 ; Stationery and Printing, £260 ; Advertising, £450.

H. Dixon and Kemp are trading in partnership as stationers in Fleet Street, and printers in Clerkenwell. Dixon manages the former department, the printing works being in charge of Kemp. It is agreed that the printing works shall have credit for 90% of the printing sales, that all sums which cannot be definitely allocated to either department shall be charged two-thirds to Stationery and one-third to Printing, and that each partner shall be entitled to half the profits of his department. After charging interest at 5% on capital against the remaining profits, the balance is to be divided in the proportions of five and three. The following is the Trial Balance on 30th June, 1941.

	£	£
Dixon, Capital, 1st July, 1940		4,000
Kemp, do. do.		3,000
Printing Works Lease and Building, 1st July, 1940, expires 1st July, 1950	3,750	
Stocks on hand, Fleet Street, 1st July, 1940	1,846	
Stocks on hand, Clerkenwell, 1st July, 1940	3,194	
Loan on Mortgage of Printing Works at 5%		2,100
Instalment paid off Mortgage, 30th June, 1941	300	
Plant and Machinery, Clerkenwell	2,480	
Furniture and Fittings, Clerkenwell	190	
Furniture and Fittings, Fleet Street	560	
Sales, Stationery and Sundries		9,463
Printing Sales		14,290
Purchases, Fleet Street	7,247	
Paper Purchases, Clerkenwell	4,821	
Printing Ink, Clerkenwell,	1,619	
Type and Sundries, Clerkenwell	1,208	
Wages and Salaries, Fleet Street	875	
Wages and Salaries, Clerkenwell	2,749	
Carried forward	£30,839	£32,853

	£	£
Brought forward	30,839	32,853
Rent, Fleet Street	350	
Ground Rent, Clerkenwell	100	
Debtors	4,736	
Creditors		6,556
Cash at Bankers	571	
Cash in hand	24	
Travellers' Salaries and Commission	786	
General Expenses, Carriage, etc.	522	
Light, Fuel, and Insurance, Fleet Street	76	
Rates, Taxes, and Insurance, Clerkenwell	262	
Fuel and Light, Clerkenwell	119	
Bad Debts written off	48	
Reserve for Doubtful Debts		251
Repairs and Renewals, Clerkenwell	82	
Interest on Loan	105	
Dixon, Drawings, including Income Tax	572	
Kemp, do. do.	468	
	£39,660	£39,660

Write off Printing Works Lease, £375, Plant and Machinery, 7½%, Furniture and Fittings, 10%; bring Reserve for doubtful debts to 6¼% on Debtors; the Stocks on hand at 30th June, 1941, were, Fleet Street, £2,382; Clerkenwell, £3,433. Prepare Profit and Loss Account for the year ended 30th June, 1941, and Balance Sheet as on that date, keeping the partners' Current Accounts distinct from Capital Accounts.

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i. The following figures were extracted from the books of James Wendover, who carried on business in two departments, A and B.

		£	£
Stock,	A	10,000	
"	B	2,000	
Purchases,	A	30,000	
Discounts,	A	800	
Wages,	A	3,000	
"	B	3,000	
Rent,	A	250	
"	B	400	
Rates,	A	100	
"	B	150	
Gas and Electricity,	A	50	
"	B	200	
Travelling,	A	100	
"	B	50	
Motor Expenses,	A	300	
"	B	200	
Bank Charges	A	75	
"	B	25	
General Expenses,	A	350	
"	B	250	
Sales,	A		40,400
"	B		8,000
Discounts,	A		600
Income Tax,	A and B	1,500	
	Carried forward	£52,800	£49,000

		£	£
	Brought forward	52,800	49,000
Debtors		10,000	
Buildings		20,000	
Plant and Machinery		5,000	
Motor Waggon		1,000	
Creditors			8,000
Bank			2,000
Capital			31,800
Drawings		2,000	
		£90,800	£90,800

The stock of the A department at 31st December was £12,000, and the stock of the B department—*nil.*

You are required to prepare separate Trading and Profit and Loss Accounts for the two departments for the year ended 31st December, and Balance Sheet at that date.

Provide £500 for Bad Debts on the A department and $7\frac{1}{2}\%$ Depreciation on the Plant and Machinery in B department. Charge 5% Interest on capital to P. & L. account, and $1\frac{1}{4}\%$ discount on Debtors before providing for Bad Debts, and $2\frac{1}{2}\%$ on Creditors to A department. Reserve £2,500 for Income Tax.

J. X. & Y., Merchants, carry on their business through five departments, numbered 1 to 5. During their first trading period the results are :—

Departments	1	2	3	4	5
	£	£	£	£	£
Purchases	25,000	15,000	5,000	13,000	17,000
Sales	24,000	10,500	4,750	11,500	15,000
Stock on hand	6,000	7,000	1,000	3,000	6,000

The expenses, which are to be charged to each department in proportion to the purchases for that department, are as follows :—

	£
Salaries and Commissions	2,750
Rent and Rates	750
General Expenses	600
Insurances	250

Show the final result and the percentage on sales in each department, and also the combined results with percentage on total sales.

K. What is meant by the term "Tabular Book-keeping"? In what circumstances is the system advantageous? Submit the ruling of a book framed on these lines, and describe and illustrate the method of keeping it.

L. Sketch the system of book-keeping and accounts you would recommend for an hotel.

M. Give the form of a tabular ledger for a gas. water, or electric light company, stating its special features and characteristics.

CHAPTER XII

BRANCH ACCOUNTS

BRANCH Accounts record the trading transactions of different branches of the same business, whether such branches are situated in the same town or at other towns in this country or abroad. These accounts may be divided into the following main classes :—

(1) Home Branch Accounts—
 (a) Where all transactions are recorded at Head Office.
 (b) Where the branches keep their own records.
(2) Colonial and Foreign Branch Accounts.

The bookkeeping systems employed necessarily vary with the nature of the business transacted and with the special circumstances of each case. For example, while colonial and foreign branches almost invariably trade independently and thus record their own transactions, home branches include such varied types as the following :—

(1) Branches for the receipt of orders transmitted to, and executed by, the Head Office.
(2) Distributive branches or depots for the execution of orders from Head Office.
(3) Branches trading independently.
(4) Retail selling branches.

The accounts relating to the first two sub-classes of home branches will consist mainly of expenditure accounts for wages, salaries, travelling and sundry expenses, etc., and do not call for detailed consideration. Usually, the branch manager is supplied with a round sum for disbursements, and weekly or other periodical returns are made by him to Head Office, upon receipt of which, the Head Office forwards a replacement cheque for the total amount of the branch expenditure. The expenditure returns are analysed and the totals of each class of expenditure are debited to the appropriate Branch Expenditure Account in the Head Office books, a credit entry for the final total being made in the Branch Cash Account.

Branch Transactions recorded at Head Office.

Where the branch trades independently—i.e., when it makes its own purchases and sales or, alternatively, receives goods

from Head Office which it sells to its own customers, either for cash or on credit, but the whole of the transactions are recorded in the Head Office books—there is little to distinguish the branch accounts from departmental accounts. In effect, the branch is but a separate department which, for convenience of trade, is housed in a separate district or town. While, however, the principles of departmental accounts apply to this class of branch accounts, there must necessarily be several points of divergence in actual practice which modify the following summary of the branch transactions and procedure.

Periodical returns (usually daily returns for credit sales but weekly returns of purchases and expenses) are made by the branch to the Head Office. In some cases, invoices for sales on credit are despatched to the customer by the branch; in other cases, an advice note only is sent, and the invoice despatched by the Head Office, on receipt of the branch daily returns, the amount owing being recorded in the usual way in the books of account. In such cases, the accounts are usually collected by the Head Office, and the only cash received by the branch will be for cash sales, the amount of which is generally paid in full into a local branch of the concern's bankers for transmission to the Head Office.

Invoices for purchases made by the branch (after being certified as correct by the branch manager) are despatched to the Head Office, where they are entered in the usual books of account. Where the Head Office supplies the branch with goods, the value is debited to an account for that branch in the Head Office General Ledger, and is credited to a "Goods sent to Branches Account." Supplies to branches are eventually credited to the Head Office Trading Account where they should be shown as a separate item, while purchases made by branches are debited to the Branch Trading Account.

Branch expenses are met out of cash supplied by the Head Office specially for that purpose, usually on the imprest system. The transmission of separate remittances from the branch for cash sales and separate remittances to the branch for expenditure tends to the simplification of the financial records, and, incidentally, affords a more efficient check upon the branch management.

In some cases, a separate ledger is kept for each branch, in which is recorded the whole of the accounts relating to that branch, while an adjustment account for each separate branch ledger is kept in the General Ledger on the same lines as the adjustment accounts described in connection with self-balancing ledgers.

The Trading and Profit and Loss Accounts relating to such branch accounts are compiled in the same manner as those for departmental accounts.

Branch Transactions recorded in Books kept by Branches.

Where a branch trades independently of the Head Office to any extent, it is usually more convenient for the branch to establish its own complete book-keeping system, on double-entry principles. In such cases, the Head Office will open a Branch Account in its General Ledger, debiting this account with cash supplied by Head Office and with expenditure on stock and fixtures, etc., for the branch, and crediting the account with returns and remittances made by the branch to Head Office.

Similarly, the branch will open, in its own books, a Head Office Account which is credited with the amount of goods, stock, and cash received, and debited with returns and remittances to Head Office. In effect, therefore, the bookkeeping relationship between Head Office and branches when this system is adopted is practically that of debtor and creditor, and a debit balance on the Branch Account in the Head Office books represents the amount "owing" to the Head Office by the branch concerned. In other words, the debit balance is an asset representing the net capital invested in the branch.

From the branch view-point, the credit balance of its Head Office Account is its net trading capital, and represents its liability to the Head Office.

When the arrangement here described is adopted, it frequently happens that while the Head Office supplies goods to the branch, the latter also makes purchases on its own account. Thus, the branch trades as a separate unit, and in these circumstances it keeps its own banking account. It effects both cash and credit sales, for which it renders its own accounts to the customers, and pays any cash received into its own banking account. Similarly, payments for purchases and other expenditure are made direct by the branch on its own responsibility.

Periodically, statistical returns are made by the branch to the Head Office, showing the nature and volume of business effected, etc., while remittances are made to the Head Office, as occasion requires, in respect of—

(*a*) Goods supplied by Head Office ;
(*b*) Surplus funds.

If the branch needs further funds for trading purposes, its requirements are supplied by a remittance from Head Office.

At the end of each trading period, the branch compiles its own Trading and Profit and Loss Accounts and Balance Sheet, and forwards an authenticated copy of these documents, together with a copy of the Branch Trial Balance, to the Head Office, for incorporation in the Head Office accounts.

Incorporation of Branch Figures in the Head Office Books.

There are several methods of incorporating branch figures in the Head Office books, varying according to the circumstances of each case. For example, it is a common practice for a branch to submit to the Head Office monthly summaries of its own transactions, including, *inter alia* :—

(*a*) Total sales (cash and credit) and returns inwards.
(*b*) Total purchases and returns outwards.
(*c*) Total receipts from debtors and payments to creditors.
(*d*) Classified summary of other expenditure.
(*e*) Particulars of bad debts, losses, etc., separate detailed schedules being supplied where necessary.

The summary statement for transactions with debtors commonly takes the following form.

BRANCH A.

SUNDRY DEBTORS, 31ST JANUARY, 19..

19..		£ s. d	£ s. d.
Jan. 1	To Balance owing by debtors		1,250 10 0
„ 31	„ Sales for month		1,600 10 0
„ 31	„ Dishonoured cheques		51 0 0
„ 31	„ Other debit charges (stating nature, etc.)		*nil*
	....		
	....		
			2,902 0 0
„ 31	By Cash received from debtors	1,125 0 0	
„ 31	„ Discount allowed to debtors	62 10 0	
„ 31	„ Returns inwards	125 0 0	
„ 31	„ Bad debts	*nil*	
„ 31	„ Other items credited to debtors (stating nature, etc.)	*nil*	
	....		
	....		1,312 10 0
Jan. 31	*Balance owing by debtors*		£1,589 10 0

It will be observed that this statement is very similar, in so far as the respective items are concerned, to the adjustment account for a sales ledger kept on the self-balancing principle. The utility of this return lies in the opportunity it provides for comparison of the outstanding debtors with the turnover for the month, and for the comparison of the results attained by the various branches, in those cases where several branches exist. It is not usual for a branch keeping its accounts on these lines to

submit a detailed list of its debtors, but where any of its accounts have been outstanding longer than a specified period, a schedule of these "old accounts" is submitted to Head Office with a statement of the steps taken to recover the debts.

Even when the branches maintain full sets of account books, the practice is sometimes adopted of opening separate ledgers at Head Office for each branch, and a complete set of accounts is raised to record the monthly totals of the various transactions of each branch, as detailed on the periodical statements. The Branch Account in the Head Office General Ledger then serves the purpose of an adjustment account for the branch ledger, as it receives—

(a) The equalising total credit for the various debits to the accounts in the branch ledger; and
(b) The equalising total debit for the various credits to the accounts in the branch ledger.

As the branch ledger records summarised figures for the whole of the branch transactions, the Head Office is able to construct the Trading and Profit and Loss Accounts relating to each branch in the usual manner. These branch ledgers are sometimes arranged in columnar form, so that one folio records, side by side, the particulars relating to several branches.

Incorporating the Final Accounts in Head Office Books.

It more generally happens, however, that where the branch keeps its own books, only the final figures relating to the branch transactions are incorporated in the Head Office books. This incorporation may be effected by two methods, which may conveniently be described as the "Simple" and "Complete" methods.

THE "SIMPLE" METHOD OF INCORPORATING BRANCH FIGURES.

Under the "Simple" method, the procedure is as follows:—

(1) Debit the Branch Account with the net profit disclosed by the Branch Profit and Loss Account, and credit the General Profit and Loss Account. (If a loss is sustained, the Branch Account is credited and the General Profit and Loss Account is debited.)

(2) When preparing the General Balance Sheet, add the figures of branch stock, debtors, creditors, etc., to the figures for similar items in the Head Office accounts, *but omit the balance of the Branch Account.*

The following example illustrates this method :—

EXAMPLE.

The Reading branch of Universal Traders, Ltd., closed its books on 30th June, when the following Trial Balance was compiled.

	Dr.	Cr.
	£	£
Sundry Debtors	2,400	
Sundry Creditors		1,720
Cash in hand	380	
Fixtures, Furniture, etc.	1,250	
Stock at 1st January	450	
Goods from Head Office	6,800	
Purchases	13,290	
Sales		22,500
Wages and Salaries	1,100	
Trade Expenses	1,050	
Head Office Account		2,500
	£26,720	£26,720

The closing stock on 30th June was £520. The balance on Head Office Account at January 1st was £2,300 and the cash remitted to Head Office was £6,600. Close the branch books, prepare the Branch Trading Account and Balance Sheet, and incorporate the final result in the Head Office Books.

NOTE.—In practice, a more comprehensive trial balance with fuller details of expenses, etc., would generally be obtained.

Branch Books.

JOURNAL.

			£	£
19..				
June 30	Branch Trading Account	Dr.	22,690	
	To Sundries—			
	Stock			450
	Goods from Head Office			6,800
	Purchases			13,290
	Wages and Salaries			1,100
	Trade Expenses			1,050
	Being balances transferred.			
June 30	Sundries—	Dr.		
	To Branch Trading Account			23,020
	Sales Account		22,500	
	Stock		520	
	Being balance transferred and closing stock at this date.			
June 30	Branch Trading Account	Dr.	330	
	To Head Office Account			330
	Being net profit for half-year transferred.			

BRANCH TRADING ACCOUNT.

Dr. FOR THE HALF-YEAR ENDED 30TH JUNE, 19.. *Cr.*

		£			£
	To Stock at 1st January	450		By Sales . . .	22,500
	„ Goods from Head Office . .	6,800		„ Stock at 30th June	520
	„ Purchases . .	13,290			
	„ Wages and Salaries .	1,100			
	„ Trade Expenses .	1,050			
	„ Balance, being Net Profit transferred to Head Office Account . .	330			
		£23,020			£23,020

Dr. HEAD OFFICE ACCOUNT. *Cr.*

19..			£	19..			£
June 30	To Balance . . .	c/d.	2,830	June 30	By Balance . . .	b/d.	2,500
				„	„ Trading Account .		330
			£2,830				£2,830
				July 1	By Balance . . .	b/d.	2,830

BRANCH BALANCE SHEET.

AS AT 30TH JUNE 19..

Liabilities.		£	*Assets.*	£
Sundry Creditors . .		1,720	Fixtures, Furniture, etc. .	1,250
Head Office Account	£2,500		Stock-in-trade . . .	520
Add Net Profit .	330		Sundry Debtors . .	2,400
		2,830	Cash in hand . . .	380
		£4,550		£4,550

Head Office Books.

JOURNAL.

19..			£	£
June 30	Branch Account . . . . *Dr.*		330	
	To General Profit and Loss Account . . .			330
	Being net profit for the half-year as per Branch Trading Account.			

The following Branch Account in the Head Office ledger is shown to illustrate fully the transactions for the whole trading period.

Dr. BRANCH ACCOUNT. *Cr.*

19..			£	19..				£
Jan. 1	To Balance . . .	*b/d.*	2,300	June 30	By Cash Remittances .			6,600
June 30	„ Goods . . .		6,800	„ 30	„ Balance . . .		*c/d.*	2,500
			£9,100					£9,100
June 30	To Balance . . .	*b/d.*	2,500	June 30	By Balance—	£		
„ 30	„ Net Profit . .		330		Fixtures, etc.	1,250		
					Stock-in-trade	520		
					Debtors .	2,400		
					Cash .	380		
						4,550		
					Less Creditors	1,720		
							c/d.	2,830
			£2,830					£2,830
June 30	To Balance . . .	*b/d.*	2,830					

It will be observed that the balance of the Branch Account consists of the branch assets less its liabilities. In some cases, the Branch Account is credited with the closing assets, which are carried down as the first debit entry for the new period. Similarly, the Branch Account is debited with the closing liabilities, which are carried down as the first credit entry for the new period.

THE "COMPLETE" METHOD OF INCORPORATING BRANCH FIGURES.

We have seen that under the "Simple" method the Branch Account is debited only with the net profit realised, but under the "Complete" method, which will now be described, the Head Office incorporates in its general ledger a complete copy of the Branch Trading and Profit and Loss Accounts. To effect this, and to maintain the double entry principle throughout, it is necessary, *at the end of the trading period*, to

(1) Debit the Branch Account with all items credited to the Branch Trading and Profit and Loss Accounts; and to

(2) Credit the Branch Account with all items debited to the Branch Trading and Profit and Loss Accounts.

The Branch Account thus serves the purpose of an adjustment account to its fullest extent, and if the figures given in the example shown on the preceding pages are adopted, the Branch Account in the Head Office books will appear as follows :—

Dr. BRANCH ACCOUNT. *Cr.*

19..			£	19..			£
June 30	To Balance, *b/d.*		2,500	June 30	By Branch Trading Account—	£	
„ 30	„ Branch Trading Account—	£			Stock at 1st Jan.	450	
	Sales	22,500			Goods from H.O.	6,800	
	Stock at 30th June	520			Purchases	13,290	
			23,020		Wages and Salaries	1,100	
„ 30	„ Balance, *c/d.*—				Trade Expenses	1,050	
	Creditors		1,720				22,690
				„ 30	„ Balance, *c/d.*—		
					Fixtures	1,250	
					Stock-in-Trade	520	
					Debtors	2,400	
					Cash	380	
							4,550
			£27,240				£27,240
June 30	To Balance, *b/d.*		4,550	June 30	By Balance, *b/d.*		1,720

Remittances in Transit and the Amalgamation of Balance Sheets.

When a combined Balance Sheet of Head Office and branches is being prepared, care must be taken to see that the balance of the Head Office Account in the Branch Trial Balance agrees with the balance of the Branch Account in the Head Office books. Every entry in the Head Office books should be duplicated in the branch books and *vice versa* ; consequently, the balances should agree exactly.

Where, however, remittances or goods are despatched on the last day of the financial period, they will not be received by the Head Office or branch, as the case may be, until the first day of the new trading period, and the respective trial balances will accordingly differ by the amount of the remittances or goods in transit. Items in transit may be placed to special Suspense Accounts in the Head Office books or, alternatively, may be carried down as balances on the Branch Accounts. Such items should be shown in an Amalgamated Balance Sheet as follows :—

	£	£
Stock-in-trade—		
Reading	520	
London	1,250	
In transit	150	
		1,920
Cash—		
Reading	180	
London	650	
In transit	120	
		950

The amalgamated balance sheets prepared for the use of the partners of a firm or for the directors and chief officials of companies will show full details in the above manner, but published balance sheets will show the combined totals only, i.e. £1,920 and £950 in the above illustration. Where there is a considerable number of branches the columnar form of balance sheet may be used with advantage.

For examination purposes, students must be guided by the wording of the question in ascertaining the examiner's requirements, but generally speaking, it is better to submit a balance sheet showing full details.

EXAMPLE.

The following position is shown by the books of a London business and its two branches at 31st December 19.. :—

BALANCE SHEET.

	London.	Branch A.	Branch B.		London.	Branch A.	Branch B.
	£	£	£		£	£	£
Capital	25,000			Plant and Machinery	12,000		
Creditors	3,000	3,900	4,000	Stock	6,900	600	1,800
Current Accounts—				Debtors	6,500	700	2,200
Branch A	1,500			Current Accounts—			
Head Office			300	Branch B	1,100		
Profit and Loss				Head Office		2,400	
Account	7,000			Cash	10,000	200	300
	£36,500	£3,900	£4,300		£36,500	£3,900	£4,300

Upon investigation it was found that the following transactions had taken place on 31st December :—

London forwarded goods to the value of £500 to Branch A and £600 to Branch B, which were not received by the Branches until 3rd January.

Branch A remitted £400 cash to London, received by London on 2nd January.

Branch B returned to London goods to value of £200 which were not received by London until 4th January.

Show the Journal entries in the Head Office books to adjust the above transactions and prepare an amalgamated Balance Sheet at 31st December.

Head Office (London) Books

JOURNAL.

		Dr. £	Cr. £
19..			
Dec. 31	Goods in Transit Account . . . Dr.	1,100	
	To Branch A Current Account . .		500
	„ Branch B Current Account . .		600
	Being goods sent to Branches, not yet delivered.		
Dec. 31	Cash in Transit Account . . . . Dr.	400	
	To Branch A Current Account . .		400
	Being cash remitted by Branch, not yet received.		
Dec. 31	Goods in Transit Account . . . Dr.	200	
	To Branch B Current Account . .		200
	Being goods returned by Branch, not yet received.		

BALANCE SHEET.
AS AT 31ST DECEMBER 19..

Liabilities.	£	£	*Assets.*	£	£
Capital . .		25,000	Plant and Machinery—London .		12,000
Creditors—			Stocks—		
London . .	3,000		London . .	6,900	
Branch A .	3,900		Branch A .	600	
Branch B. .	4,000		Branch B .	1,800	
		10,900	In Transit .	1,300	
Profit and Loss Account . .		7,000			10,600
			Debtors—		
			London . .	6,500	
			Branch A .	700	
			Branch B .	2,200	
					9,400
			Cash—		
			London . .	10,000	
			Branch A .	200	
			Branch B .	300	
			In Transit .	400	
					10,900
		£42,900			£42,900

Retail Selling Branches.

In recent years there have been established many "Multiple Shop Companies," i.e., companies with many retail branch shops and a central store from which the branches are supplied with the commodities and materials dealt in by them. All purchases are made by headquarters, which thus becomes a distributing centre, and all accounts are kept at the Head Office.

The function of these retail shops is to effect sales, and as the managers and salesmen often have little or no knowledge

of accounts, it is necessary that the book-keeping system should be of the simplest character.

A special feature of this class of account is that the commodities supplied are usually charged out to the branches at the *retail selling price*, and the manager is required to account on that basis for the whole of the stock supplied to him. In this way the cost price of the goods is not disclosed to the branch manager. Most of these retail branches effect cash sales only, and do not therefore require elaborate book-keeping systems.

A limited form of credit is, however, granted in certain districts, where some local residents are in the habit of paying their accounts weekly or monthly. In such cases, a Sales Day Book and Ledger will be required.

The records kept at the branch will consist mainly of a Stock Account and a Cash Account, which are kept in books specially prepared and provided by Head Office for the use of the branch manager. The following forms are in common use :—

Dr. STOCK ACCOUNT. *Cr.*

Date.		£ s. d.	£ s. d.	Date.		£ s. d.	£ s. d.
	To Commencing Stock				By Cash Sales		
	,, Goods from Head Office				Monday .		
	Monday . .				Tuesday .		
	Tuesday .				Wednesday .		
	Wednesday .				Thursday .		
	Thursday .				Friday . .		
	Friday . .				Saturday .		
	Saturday .				,, Credit Sales for week .		
					,, Returns to Head Office .		
					,, Allowances for Damages, Breakages, etc. . .		
					,, Balance, being Closing Stock on hand . .		
			£				£

Dr. WEEKLY CASH ACCOUNT. *Cr.*

Date.		£ s. d.	£ s. d.	Date.		£ s. d.	£ s. d.
	To Balance in hand				By Payments into Bank		
	,, Cash Sales—				Monday . .		
	Monday . .				Tuesday . .		
	Tuesday. .				Wednesday .		
	Wednesday .				Thursday .		
	Thursday .				Friday . .		
	Friday . .				Saturday .		
	Saturday .				,, Balance in hand . .		
	,, Receipts from Debtors . (Details for each day)						
			£				£

Note.—The usual rule is for each day's takings to be banked in their entirety the following morning. Thus, the balance in hand at the end of the week will consist of Saturday's takings plus the "till money," i.e., the money kept in the till for purposes of change.

Dr. SUNDRY DEBTORS ACCOUNT. *Cr.*

19..		£ s. d.	19..		£ s. d.
	To Opening Balance .			By Cash Received .	
	„ Credit Sales for week . . .			„ Allowances . .	
				„ Bad Debts . .	
				„ Closing Balance .	
		£			£

Where the branch does a cash trade only, the references to the credit sales and to the total Sundry Debtors Account may be omitted. The books supplied to the branch usually have the three foregoing accounts printed all on one page, so as to record a consecutive weekly summary of the whole of the branch transactions. Copies of these accounts are transmitted to the Head Office each week, together with detailed schedules relating to the stock and debtors. The schedule relating to debtors is sometimes omitted, except as regards amounts outstanding for more than four weeks.

The branch expenditure will consist mainly of wages and petty expenses, for which a special return is made by the branch. Usually the Head Office makes a special remittance on the imprest system in respect of this expenditure, but in some cases the branch manager is allowed to use part of his cash receipts from sales to pay wages and expenses, and, in that event, the form of weekly cash account given on page 487 is revised to include summarised particulars of the expenditure.

Head Office Records for Retail Branches.

A ledger for each branch will be kept at the Head Office, and will contain accounts recording particulars of—

(1) Branch Stock,
(2) Branch Expenses, and
(3) Branch Total Debtors.

The accounts for Branch Fixed Assets may also be included, but, more generally, these are kept in the General Ledger.

As previously indicated, the goods sent to branches are usually charged out at selling prices, and the amount of each invoice is debited to the Branch Stock Account, the equalising credit entry appearing in the "Goods Sent to Branches Account" kept in the General Ledger. The amounts received for cash sales are credited to the Branch Stock Account from the Cash Received Book, while the weekly total of credit sales is debited to the Branch Total Debtors Account and credited to the Branch Stock Account. Returns to the Head Office are credited to the Branch Stock Account, and adjusting entries are also made for allowances on account of damaged goods, breakages, and losses through deterioration of perishable articles, etc.

The branch weekly returns of credit sales, payments by debtors, allowances to debtors, losses through bad debts, etc., form the basis of entries to the Branch Total Debtors Account, and for the contra entries in the appropriate nominal accounts. The closing balances of the Branch Total Debtors Account must, of course, agree with the final list of outstanding debtors.

Branch expenses are mainly paid direct from the Head Office, local petty expenses being met from cash supplied by the Head Office under the imprest system. Hence items of expense incurred on account of a branch or branches are debited to the appropriate expense accounts from the Head Office cash book.

At the end of the trading period, the balance of the Branch Stock Account should be exactly equal to the stock on hand at the branch, but in practice, there are often slight differences—usually deficiencies. For example, it is practically impossible to weigh up exactly 112 separate pounds of butter from a cwt. cask of that commodity. Consequently, it is usual in practice to make certain allowances in respect of such necessary differences, but when the average margin of such allowances is exceeded, inquiries should be made as to the cause of the difference before the loss is written off.

The balance of the Branch Stock Account must be adjusted to its true selling figure, and the resulting balances brought down. For purposes of the Head Office final accounts the branch stock must be reduced to its cost price, but it is not desirable to interfere with the figures in the branch accounts. The best method is to make the adjustment in the Head Office General Ledger. The Goods Sent to Branches Account is credited with the value of the total amount of goods issued to the various branches, and is debited with returns to the Head Office. If this account is debited with the closing stock at its selling price (such amount being brought down as a credit balance to form the first credit entry for the new period), the difference between the aggregate total credits and total debits will represent the net actual total sales of the branch, and may be transferred to the credit of the Trading Account for the period.

The credit balance of the Goods Sent to Branches Account neutralises the debit balance of the Branch Stock Account, and both figures are ignored by Head Office in the preparation of the final accounts. The closing stock is then calculated at cost price (particular note being taken whether the percentage added to cost is based on cost or on selling price) and brought into the final accounts (Trading Account and Balance Sheet), at cost, in the usual manner.

Alternatively, the cost price of the closing stock at the branch can be ascertained from the Head Office books by opening therein a " Branch Adjustment Account " on the following lines :—

(1) When issuing goods from Head Office to branch, debit the *selling* price of the goods to the Branch Stock Account, credit the *cost* price to the Goods Sent to Branches Account, and credit the profit " loading " to Branch Adjustment Account.

(2) When goods are returned by the branch to the Head Office, credit the selling price to the Branch Stock Account, debit the cost price to the Goods Sent to Branches Account, and debit the profit " loading " to Branch Adjustment Account.

(3) Upon receiving the periodical Branch return of sales, credit the Branch Stock Account, and debit Cash Account or Branch Debtors Account, as the case may be.

At the end of the year or other financial period stock is taken at the branch *at selling prices.* This figure is then credited to the Branch Stock Account and brought down as a balance on this account. At the same time, a sum equivalent to the unrealised profit " loading " on the closing stock is debited to the Branch Adjustment Account and carried down to the credit thereof. Thus, for balance sheet purposes, the cost price of the stock may be ascertained from the Head Office books by deducting the credit balance on the Branch Adjustment Account from the debit balance on the Branch Stock Account.

Assuming that all goods have been sold at the invoiced prices, that no wastage or pilferage of goods has taken place, and that stock has been taken correctly, the Branch Stock Account should exactly balance, and the difference on the Branch Adjustment Account should represent the gross profit made by the branch. As already pointed out, however, small differences between actual stock and book stock are almost inevitable in practice, and usually result in the debit side of the Branch Stock Account being greater than the credit side. In order to balance off this account the difference is credited thereto and debited to the Branch Adjustment Account, since its effect is to reduce the apparent gross profit made. If, however, the debit side of the Branch Stock Account is less than the credit side, the difference is debited thereto and credited to the Branch Adjustment Account, thus increasing the apparent gross profit made. Finally,

(4) the balance on Goods Sent to Branches Account will be credited to Head Office Trading Account.

EXAMPLE.

On 1st January, 19.., goods costing £3,000 are invoiced to a branch, and charged up at a selling price designed to produce a gross profit of 25% on the selling price, that is, 33⅓% on cost price. At the end of the month the branch report shows that the sales were £2,500. Goods invoiced at £40 have been returned to Head Office. The closing stock is £1,440, at selling prices.

Record the above transactions in the Head Office ledger and balance off the accounts concerned at 31st January.

Dr. BRANCH STOCK ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Sundries—Goods sent to Branch at Selling Price . . .		4,000	Jan. 31	By Sales . . .		2,500
					" Returns from Branch, at Selling Price .		40
					" Stock, at Selling Price	*c/d.*	1,440
					" Branch Adjustment A/c., Loss in Stock		20
			£4,000				£4,000
19..							
Feb. 1	To Stock . . .	*b/d.*	1,440				

Dr. BRANCH ADJUSTMENT ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 31	To Branch Stock A/c.—25% on £40 Returns		10	Jan. 1	By Branch Stock A/c.—25% on £4,000 .		1,000
	" Do.—Loss in Stock .		20				
	" Balance (25% on £1,440) . .	*c/d.*	360				
	" Branch Profit and Loss A/c., Gross Profit transferred .		610				
			£1,000				£1,000
				19..			
				Feb. 1	By Balance . .	*b/d.*	360

Dr. GOODS SENT TO BRANCHES ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 31	To Branch Stock A/c.—Returns at cost .		30	Jan. 1	By Branch Stock A/c.—Goods at cost .		3,000
	" Head Office Trading Account . .		2,970				
			£3,000				£3,000

If a Balance Sheet were prepared at 31st January, the above stock would be included therein " at cost £1,080 " (i.e., £1,440 *less* £360).

Alternatively, instead of maintaining separate Branch Stock Accounts and Branch Adjustment Accounts for each branch, a single account with double columns can be opened, one column

to record the goods at selling price (this column is purely memorandum in its nature) and the other column to record the essential double entry detail of purchases and stocks at cost price and sales at selling price. If this method is adopted, the transactions set out on page 491 would appear as follows :—

Dr. BRANCH STOCK ACCOUNT. *Cr.*

			Invoice Price.					Invoice Price.	
19..			£	£	19..			£	£
Jan. 31	To Goods sent to Branch .		4,000	3,000	Jan. 31	By Sales . .		2,500	2,500
„ 31	„ Branch Profit and Loss Account .			610		„ Returns from Branch .		40	30
						„ Balance—Stock .	c/d.	1,440	1,080
						„ Loss on Stock		20	
			£4,000	£3,610				£4,000	£3,610
Feb. 1	To Balance—Stock	b/d.	1,440	1,080					

In some cases (e.g., where prices vary considerably and it is impossible to determine the selling price in advance), goods are invoiced to the branches at cost plus a certain percentage. The treatment of the profit "loading" in the Head Office books is similar to that shown in the above example, but in this case there will be a balance on the Branch Stock Account representing the difference between invoice prices and selling prices of goods sold, which must be transferred to the Branch Profit and Loss Account, *in addition to* the profit revealed by the Branch Adjustment Account. Any loss on branch stock is not revealed by this method, but is concealed in the profit shown on the Branch Stock Account.

EXAMPLE.

The Alpha Trading Co., Ltd., invoices goods to its Blanktown Branch at cost plus 25%. Both cash and credit sales are effected by the branch. Branch expenses are paid direct from Head Office, all cash received by the branch being remitted to Head Office. The following are the details of the transactions for the six months ended 30th June, 19.. :—

	£
Goods received from Head Office, at invoiced prices .	10,000
Returns to Head Office, at invoiced prices . .	250
Stock, 1st January, at invoiced prices . . .	2,500
Credit Sales for the half-year	5,500
Cash „ „ „	5,400
Debtors, 1st January	1,900
Cash received on Ledger Accounts . . .	5,800
Discounts allowed to customers	80
Bad Debts written off	150
Returns from customers, at selling prices . .	100

	£
Rents, Rates, etc.	120
Salaries and Wages	400
Sundry Expenses	60
Stock, 30th June, at invoiced prices . . .	2,000
Sundry Debtors, 30th June	1,270

Record the above transactions in the Head Office ledger, and close off the accounts concerned at 30th June.

Dr. BLANKTOWN BRANCH STOCK ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Balance, Stock at invoiced prices .	*b/d.*	2,500	Jan. to June	By Cash Sales . .		5,400
					,, Credit Sales . .		5,500
Jan. to June	,, Sundries, Goods sent to Branch at invoiced prices .		10,000		,, Returns to Head Office at invoiced prices . .		250
,,	,, Returns Inwards .		100				
June 30	,, Branch Profit and Loss A/c., apparent gross profit . .		550	June 30	,, Stock at invoiced prices . .	*c/d.*	2,000
			£13,150				£13,150
July 1	To Balance (Stock) .	*b/d.*	2,000				

Dr. BLANKTOWN BRANCH ADJUSTMENT ACCOUNT. *Cr.*

19..			£	19..			£
Jan. to June	To Branch Stock A/c., 20% on £250 Returns . . .		50	Jan. 1	By Balance, 20% on £2,500* . .	*b/d.*	500
June 30	,, Balance, 20% on £2,000 . .	*c/d.*	400	Jan. to June	,, Branch Stock A/c., 20% on £10,000 .		2,000
,, ,,	,, Branch Profit and Loss A/c., Profit transferred . .		2,050				
			£2,500				£2,500
				July 1	By Balance . .	*b/d.*	400

* NOTE: 25% on *cost* is 20% on invoiced price.

Dr. GOODS SENT TO BLANKTOWN BRANCH ACCOUNT. *Cr.*

19..			£	19..			£
Jan. to June	To Branch Stock A/c., Returns at cost .		200	Jan. to June	By Branch Stock A/c., Goods at cost .		8,000
June 30	,, Head Office Trading A/c. . . .		7,800				
			£8,000				£8,000

Dr. BLANKTOWN BRANCH DEBTORS ACCOUNT. Cr.

19..			£	19..			£
Jan. 1	To Balance . .	b/d.	1,900	Jan. to June	By Cash . . .		5,800
Jan. to June	,, Credit Sales . .		5,500		,, Returns Inwards .		100
					,, Discounts Allowed .		80
					,, Bad Debts written off		150
				June 30	,, Balance . .	c/d.	1,270
			£7,400				£7,400
July 1	To Balance . . .	b/d.	1,270				

Dr. BLANKTOWN BRANCH EXPENSES ACCOUNT. Cr.

19..			£	19..			£
Jan. to June	To Rents, Rates, etc. .		120	June 30	By Transfer to Branch Profit and Loss A/c. . . .		810
	,, Salaries and Wages		400				
	,, Sundry Expenses .		60				
	,, Bad Debts . .		150				
	,, Discounts . .		80				
			£810				£810

BLANKTOWN BRANCH PROFIT AND LOSS ACCOUNT

Dr. FOR THE HALF-YEAR ENDED 30TH JUNE, 19.. Cr.

19..			£	19..			£
June 30	To Branch Expenses A/c.		810	June 30	By Branch Stock A/c., Apparent Gross Profit . .		550
	,, Head Office Profit and Loss A/c., Net Profit		1,790		,, Branch Adjustment A/c., Gross Profit "Loading" on Goods Sold . .		2,050
			£2,600				£2,600

Dr. [EXTRACTS FROM] CASH BOOK. Cr.

19..			£	19..			£
Jan. to June	To Blanktown Branch Stock A/c.—Cash Sales . . .		5,400	Jan. to June	By Blanktown Branch Expenses A/c.—Rents, Rates, etc.		120
	,, Blanktown Branch Debtors A/c.—Receipts from Debtors		5,800		,, Salaries and Wages		400
					,, Sundry Expenses .		60

In addition to the branch ledgers a Statistical Stock Book is often kept at the Head Office to record the movements of stock at various branches. Such books are commonly arranged in columnar form to accommodate the particulars relating to several branches in one district or one area, as shown in the following example :—

STATISTICAL STOCK BOOK.

		Branch A.		Branch B.		Additional columns for other branches as required.	Total.	
		Debits.	Credits.	Debits.	Credits.		Debits.	Credits.
19..		£ s. d.	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.
Jan. 1	To Stock on hand							
" 8	" Goods sent to Branches .							
" 8	By Returns to Head Office							
	" Sales for week							
" 8	" Allowances for Damages, etc. . .							
" 8	" Adjustments .							
" 8	" Balance c/d. (Closing Stock) .							
		£	£	£	£		£	£
Jan. 8	To Balance b/d. .							

A book ruled on similar lines to the following example is sometimes kept at Head Office. Such a book provides an excellent summary of the branch trading and is particularly useful where the branches are numerous. A page is provided for each branch, and as the complete weekly record takes only one line, half-yearly or even yearly totals can be shown on one page. Further columns are sometimes provided, e.g., the Expenses column may be divided so that the various expenses may be shown in detail.

Branch...... HEAD OFFICE STATISTICAL BOOK.

Week Ending	Opening Stock on Hand (*selling price*).	Goods Issued (*selling price*).	Sales.	Closing Stock on Hand (*selling price*).	Gross Profit ..% *on sales*.	Expenses.	Net Profit.	Cash to Bank.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.

It may be mentioned here that the columnar types of day book, journal, cash book, and ledger are particularly applicable to branch accounts, and it is quite a common practice for these books to be arranged in such a manner that one monthly total only for each class of transaction is posted to the respective accounts in the branch ledgers and Head Office General Ledger.

In some businesses it is not practicable to issue goods to branches at selling prices, owing to the goods being of a perishable nature, or where varying prices are charged to customers according to the quantities purchased. Goods may then be supplied to branches at cost, this method having the advantage of simplicity, but the disadvantage that a less precise check on stock at the branches is possible. This disadvantage may be overcome to some extent if Head Office employs stocktakers, who will visit the branches to take stock without previous notice to the branch managers. Comparative stock statements should be kept on the lines of the statement on page 531, the stocks as valued by the stocktakers being compared with the estimated stocks as shown by the statement.

Differences in stocks will usually be due to breakage of bulk or perished goods, and if normal, may be passed. If the difference is abnormal, careful enquiry must be made as to the cause.

The entries in the Head Office books will be similar to those required when goods are supplied at selling price, except that no adjustments are necessary for profit included in stock.

EXAMPLE.

The Beta Trading Co. supplies goods to its Country Branch at cost. All cash received is remitted to Head Office daily, and all expenses are paid from Head Office. From the following particulars write up the accounts in the Head Office books and prepare a Branch Profit and Loss Account for the year ended 31st December 19..

	£
Goods sent to Branch, at cost	2,000
Goods returned to Head Office, at cost	100
Cash Sales	1,600
Credit Sales	950
Expenses paid by Head Office	340
Commencing Stock	500
,, Debtors	250
,, Cash (Float)	10
Closing Stock	400
,, Debtors	275
,, Cash (Float)	10
Discounts Allowed	25
Cash received from Debtors	900

Dr. COUNTRY BRANCH STOCK ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Balance	b/d	500	Dec. 31	By Returns to H.O.		100
Dec. 31	,, Goods from H.O.		2,000	,, 31	,, Cash Sales		1,600
,, 31	,, Gross Profit to Profit and Loss Account		550	,, 31	,, Credit Sales		950
				,, 31	,, Stock on Hand	c/d.	400
			£3,050				£3,050
Dec. 31	To Balance	b/d.	400				

Dr. GOODS SENT TO COUNTRY BRANCH ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 31	To Returns from Branch		100	Dec. 31	By Branch Stock Account		2,000
" 31	" Head Office Trading Account . .		1,900				
			£2,000				£2,000

Dr. COUNTRY BRANCH DEBTORS ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Balance . . .	b/d	250	Dec. 31	By Cash		900
Dec. 31	" Sales		950	" 31	" Discounts . .		25
				" 31	" Balance . . .	c/d	275
			£1,200				£1,200
Dec. 31	To Balance . . .	b/d	275				

Dr. COUNTRY BRANCH EXPENSES ACCOUNT. *Cr.*

19..			£	19..			£
Dec. 31	To Sundry Expenses .		340	Dec. 31	By Profit and Loss Account . .		365
" 31	" Discounts . .		25				
			£365				£365

Dr. COUNTRY BRANCH CASH ACCOUNT. *Cr.*

19..			£	19..			£
Jan. 1	To Balance . . .	b/d	10	?	By Remittances . .		2,500
?	" Cash Sales . .		1,600	Dec. 31	" Balance . .	c/d	10
?	" Debtors . . .		900				
			£2,510				£2,510
Dec. 31	To Balance . . .	b/d	10				

Dr. COUNTRY BRANCH PROFIT AND LOSS ACCOUNT. *Cr.*
FOR THE YEAR ENDED 31ST DECEMBER, 19 ..

		£				£
To Expenses * . .		365		By Gross Profit from Branch Stock Account . .		550
" Balance, Net Profit .		185				
		£550				£550

* In practice these would be detailed.

INTER-BRANCH TRANSACTIONS

In most cases the transactions to be recorded in connection with branch accounts consist solely of dealings between the Head Office and the branches, but in some cases the branches are allowed to deal directly with each other. In these circumstances it becomes necessary for each branch to keep a current account with each of the other branches in addition to its account with the Head Office, and the dealings between the branches concerned must be recorded not only in the various branch accounts, but also in some statistical form at Head Office for reference purposes.

In order to illustrate the procedure, we will consider the case of a concern having a London Head Office and branches at Cardiff, Manchester, Newcastle, Bristol, Hull, and Southampton, transactions involving transfers of goods between branches being recorded at prearranged prices, termed the inter-branch prices. On 9th February the Cardiff branch supplies goods to the Bristol branch valued at £120. To record this transaction in the Cardiff books it will be necessary to debit the current account of the receiving branch and credit an "Inter-branch Sales Account," the journal entry being :—

			£	£
Feb. 9	Bristol Branch Current Account . . . *Dr.*		120	
	To Inter-branch Sales Account			120
	Being sale to Bristol Branch.			

Similarly, if on 18th February goods valued at £50 are received at the Cardiff branch from the Manchester branch, the current account of the latter branch in the Cardiff books must be credited and an "Inter-branch Purchases Account" debited, thus :—

			£	£
Feb. 18	Inter-branch Purchases Account . . . *Dr.*		50	
	To Manchester Branch Current Account . .			50
	Being purchase from Manchester branch.			

If the dealings between the various branches are numerous, it will probably be more convenient for each branch to keep inter-branch sales and purchases books, and these would be kept in the same way as ordinary purchases and sales books, the debit or credit at the end of each period being to the Inter-branch Purchases and Sales Accounts respectively.

The position at the end of the month, in respect of the above items, would, therefore, be—

Bristol branch owes Cardiff branch £120.
Cardiff branch owes Manchester branch £50.

The matter could be adjusted by the sending of remittances for the various amounts, but there are a number of objections to such a practice. To meet the objections, the most satisfactory method is for each branch to make the necessary adjustments through the Head Office Accounts, as explained below.

At the end of each period, usually monthly, each branch will draw up a statement in the form shown below, showing the goods sent to, and received from, other branches.

Cardiff Inter-branch Transactions.

Branch.	Sales.	Purchases.
	£	£
Manchester	15	50
Newcastle	85	..
Bristol	120	25
Hull	20	75
Southampton	30	6
	£270	£156

A statement will then be sent to Head Office containing the above particulars in the following form :—

CARDIFF BRANCH,
2nd March, 19..

Statement C. 329.

To HEAD OFFICE,
LONDON.

The following transactions between this and other branches were recorded during the month of February, 19..

Please confirm the undernoted figures and make the necessary adjustments in your records :—

	Sales.	Purchases.
	£	£
Manchester	15	50
Newcastle	85	..
Bristol	120	25
Hull	20	75
Southampton	30	6
	£270	£156

James White,
BRANCH MANAGER.

Statements similar in form will be rendered by the other branches, and the resulting figures will be entered by the Head Office in the Inter-branch Journal, thus :—

INTER-BRANCH JOURNAL—28TH FEBRUARY, 19..

Goods Supplied to	Goods Supplied by						Fo.	Total. Debits.
	Cardiff.	Manchester.	Newcastle.	Bristol.	Hull.	Southampton.		
	£	£	£	£	£	£		£
Cardiff . .	..	50	..	25	75	6	55	156
Manchester . .	15	..	18	..	20	14	60	67
Newcastle . .	85	27	..	83	..	..	65	195
Bristol . .	120	63	53	..	17	47	70	300
Hull . . .	20	20	17	21	..	23	75	101
Southampton .	30	50	22	14	84	..	80	200
Total Credits .	£270	£210	£110	£143	£196	£90		£1,019
Folios . .	55	60	65	70	75	80		

Entries in Head Office Books.

It will be observed that the Inter-Branch Journal is "self-balancing"; the cross-cast total of the Total Credits at the foot of the page equalling the final total of the Total Debits column at the extreme right of the page. The Inter-Branch Journal forms the posting medium to the various branch accounts in the Head Office books. For example, the total value of the goods "purchased" by the Cardiff branch from other branches is £156, and this amount is debited to the Cardiff Branch Account. Similarly, Cardiff is credited with £270, being the value of goods "sold" to other branches. The branch accounts for Manchester, Newcastle, etc., are similarly dealt with.

Entries in Branch Books.

When the figures have been agreed, a confirmation will be sent to each branch, and the entries necessary to close the various accounts in the branch books can then be made.

For example, Cardiff branch has sold to other branches during the month goods to the value of £270, and these will have been debited in detail to the respective branch current accounts. This branch has also purchased goods amounting to £156 from other branches, and these will have been credited in the same way. To close the accounts, therefore, journal entries must be made crediting the respective branch accounts and debiting the Head Office Account with the sales, and debiting the branch accounts and crediting Head Office with the purchases.

These journal entries in the Cardiff books will appear as shown on page 501.

A similar procedure will be adopted in the case of the other branches, while the entries in the Head Office Books will be made as described above.

		£	£
Feb. 28	Head Office Account :— . . . . *Dr.*	270	
	To Sundries—		
	Manchester Branch Account . . .		15
	Newcastle " "		85
	Bristol " "		120
	Hull " "		20
	Southampton " "		30
	Being adjustment of monthly sales in accordance with Head Office Confirmation No. ..		
Feb. 28	Sundries *Dr.*		
	To Head Office Account		156
	Manchester Branch Account	50	
	Bristol " "	25	
	Hull " "	75	
	Southampton " "	6	
	Being adjustment of monthly purchases in accordance with Head Office Confirmation No. ..		

The whole of the inter-branch transactions have thus been incorporated in the Head Office Books, and the settlement between the branches and Head Office will be dealt with in the usual manner.

Various matters referred to in the preceding pages are illustrated in the following comprehensive example, to which particular attention should be paid.

EXAMPLE.

Merchants, Ltd., has a branch office in South Wales which obtains supplies partly from Head Office at cost and partly from outside suppliers. The Branch keeps a separate set of books but does not prepare Trading and Profit and Loss Accounts or Balance Sheets.

On 30th April, 1941, the following Trial Balances were extracted :—

	Head Office.		Branch.	
Share Capital, Authorised and Issued—	£	£	£	£
30,000 Shares of £1 each . .		30,000		
Fixed Assets at cost less depreciation .	16,000		8,000	
Profit and Loss Account as at 1st May, 1940		4,000		
Stocks on Hand at 1st May, 1940. .	14,000		1,900	
Debtors	17,000		1,500	
Creditors		10,000		2,050
Cash and Bank Balances . . .	3,000		1,000	
Purchases, less Returns Outwards .	120,000		6,750	
Sales, less Returns Inwards . .		140,000		20,500
Sundry Expenses	15,000		2,250	
Goods from Head Office to Branch .		12,000	11,500	
Current Accounts as at 1st May, 1940 .	11,000			10,350
	£196,000	£196,000	£32,900	£32,900

The difference between the balances on the Head Office and Branch Current Accounts is due to goods and cash being in transit at the close of the year.

Fixed Assets are to be depreciated at 10% per annum.

Stocks were valued at 30th April, 1941 at Head Office, £10,000, and at Branch, £2,100.

Prepare columnar Trading and Profit and Loss Accounts for the year for the use of Head Office and Balance Sheet as at 30th April, 1941, and close the Head Office and Branch Current Accounts and show the composition of the final balances thereon.

TRADING AND PROFIT AND LOSS ACCOUNTS

FOR THE YEAR ENDED 30TH APRIL, 1941.

Dr. | *Cr.*

	Head Office.	Branch.	Total.		Head Office.	Branch.	Total.
	£	£	£		£	£	£
To Stocks at 1st May, 1940	14,000	1,900	15,900	By Sales, less Returns Inwards	140,000	20,500	160,500
,, Purchases, less Returns Outwards	120,000	6,750	126,750	,, Goods to Branch	11,500		11,500
,, Goods from Head Office		11,500	11,500	,, Goods in Transit to Branch	500		500
,, Gross Profit *c/d*	28,000	2,450	30,450	,, Stocks as at 30th April, 1941	10,000	2,100	12,100
	£162,000	£22,600	£184,600		£162,000	£22,600	£184,600
To Sundry Expenses	15,000	2,250	17,250	By Gross Profit *b/d*	28,000	2,450	30,450
,, Depreciation of Fixed Assets	1,600	800	2,400	,, Net Loss *c/d*		600	
,, Net Profit *c/d*.	11,400		10,800				
	£28,000	£3,050	£30,450		£28,000	£3,050	£30,450
To Balance *c/f*.			14,800	By Net Profit *b/d*.			10,800
				,, Balance at 1st May, 1940 *b/f*.			4,000
			£14,800				£14,800

NOTE.—The item of £10,800 (Net Profit) in the total column represents the net profit of the Head Office (£11,400) less the net loss of the Branch (£600).

Branch Books.

Dr. HEAD OFFICE ACCOUNT. *Cr.*

		£			£
1940 May 1	To Opening Stock . .	1,900	1940 May 1	By Balance b/d. . .	10,350
1941 April 30	„ Goods from Head Office	11,500	1941 April 30	„ Sales, *less* Returns Inwards . . .	20,500
	„ Purchases, *less* Returns Outwards . . .	6,750		„ Closing Stock . .	2,100
	„ Sundry Expenses . .	2,250			
	„ Depreciation of Fixed Assets . . .	800			
	„ Balance, *c/d.* . .	9,750			
		£32,950			£32,950
			May 1	By Balance, *b/d.*— £ Fixed Assets . 7,200 Stock . . 2,100 Debtors . . 1,500 Cash and Bank Balances . 1,000 11,800 *Less* Creditors . 2,050	9,750

Head Office Books.

Dr. BRANCH ACCOUNT. *Cr.*

		£			£
1940 May 1	To Balance, *b/d.* . .	11,000	1941 April 30	By Branch Trading and Profit and Loss Accounts—	
1941 April 30	„ Branch Trading and Profit and Loss Accounts—			Opening Stock . .	1,900
	Sales, *less* Returns Inwards . . .	20,500		Purchases, *less* Returns Outwards . .	6,750
	Closing Stock . .	2,100		Goods to Branch .	11,500
				Sundry Expenses .	2,250
				Depreciation of Fixed Assets . . .	800
				„ Goods in Transit, *c/d.* .	500
				„ Cash in Transit, *c/d.* .	150
				„ Balance, *c/d.* . .	9,750
		£33,600			£33,600
May 1	To Goods in Transit, *b/d.* .	500			
	„ Cash in Transit . .	150			
	„ Balance, *b/d.*— £ Fixed Assets . 7,200 Stock . . 2,100 Debtors . . 1,500 Cash and Bank Balances . 1,000 11,800 *Less* Creditors . 2,050	9,750			

MERCHANTS LIMITED.

BALANCE SHEET.
As at 30th April, 1941.

Liabilities.	£	£	*Assets.*	£	£
Share Capital, Authorised and Issued—			Fixed Assets at cost, *less* depreciation—		
30,000 Shares of £1 each		30,000	Head Office	14,400	
			Branch	7,200	21,600
Sundry Creditors—			Stocks—		
Head Office	10,000		Head Office	10,000	
Branch	2,050		Branch	2,100	
		12,050	In Transit	500	
					12,600
Profit and Loss A/c.		14,800	Sundry Debtors—		
			Head Office	17,000	
			Branch	1,500	
					18,500
			Cash and Bank Balances—		
			Head Office	3,000	
			Branch	1,000	
			In Transit	150	
					4,150
		£56,850			£56,850

THE FOREIGN EXCHANGES

A brief consideration of the meaning and functions of the Foreign Exchanges is necessary before the book-keeping operations involved in connection with branches abroad can be dealt with and completely understood.

The Foreign Exchanges concern the settlement of indebtedness between commercial nations by means of credit documents (chiefly bills of exchange) and credit operations. The exchanges enable the debts owed *by* one nation to another to be set off and cancelled against the debts owed *to* the first nation. The enormous number of transactions which arise are settled in a simple and easy manner; the transmission of coin and bullion is avoided; and by utilising the services of those persons in the various countries who make a business of dealing in foreign exchange, the merchants of the respective countries save themselves the trouble, loss of time, and expense of making their own settlements.

Rights to foreign currencies are bought and sold by bankers and other dealers in the various financial centres in exactly the same way as are commodities, such as wheat and cotton, or investments, such as stocks and shares. The ordinary merchant or manufacturer, therefore, need not necessarily concern himself with the theory of the exchanges; it is sufficient if he understands broadly what foreign exchange is, understands what the rates mean, and knows that he can secure a quotation from his bankers when required.

Rate of Exchange.

The price of one currency in terms of another is called the rate of exchange. Put in another way, it may be defined as the expression of the number of units of one currency that will exchange for a given number of units of another currency.

In this country there are two methods of quoting foreign exchange rates. They are :—

CURRENCY RATES in which the rate is quoted at so many foreign currency units per £1 sterling, e.g., the rate with the U.S.A., which is quoted, say, at $4{\cdot}02\frac{1}{2}$, meaning that the rate of exchange is $\$4{\cdot}02\frac{1}{2}$ (i.e., 4 dollars $2\frac{1}{2}$ cents) per £1.

PENCE RATES in which the rate is quoted at so many pence or shillings and pence per foreign unit, e.g., the Indian rupee, which is quoted, say, at 1s. $6\frac{1}{32}$d. or $18\frac{1}{32}$d. per rupee.

Current rates of exchange for the various countries are quoted daily in the press in the form of a Foreign Exchange Table, which, in a good newspaper, will indicate the method of quoting and the currency unit of the centre concerned.

Reference to such a Table will show that a double quotation is usually given for each currency, representing the dealers' buying and selling rates for that currency. Thus "New York $\$4{\cdot}02\frac{1}{2}$—4·03" means that dealers will sell U.S. dollars at $\$4{\cdot}02\frac{1}{2}$ and buy them at \$4·03 per £1. A useful maxim to remember in this connection is that for currency rates a dealer buys high and sells low. From the point of view of the merchant or trader, of course, the reverse applies, for a merchant who wishes to sell dollars must accept the dealer's buying price, while if the merchant wishes to buy dollars he must pay the dealer's selling price. Thus a merchant who wishes to sell dollars will have to give \$4·03 for £1, but he will receive only $\$4{\cdot}02\frac{1}{2}$ for £1 if he wishes to buy.

The reverse applies with pence rates. If the Indian rupee is quoted $17\frac{15}{16}$—$18\frac{1}{16}$d., it means that dealers will buy rupees at 1s. $5\frac{15}{16}$d. and sell them at 1s. $6\frac{1}{16}$d. per rupee. A merchant who wishes to buy rupees will have to pay 1s. $6\frac{1}{16}$d. per rupee, while if he wishes to sell rupees, he will receive only 1s. $5\frac{15}{16}$d. per rupee.

Exchange Conversions.

The form in which a rate is quoted will affect the method of calculating the sterling equivalent of a sum in foreign currency, or the foreign currency equivalent of a sum in sterling.

Where a sum in foreign currency has to be converted into sterling and the rate is a currency rate, the sum of foreign currency is divided by the rate of exchange, the answer being the sterling equivalent. For example, the sum of \$40,300 is to be converted into sterling, the rate being \$4·03 ; the sterling equivalent is \$40,300 ÷ \$4·03 = £10,000. When a sum in sterling has to be converted into foreign currency and the rate is a currency rate,

the sterling sum is multipled by the rate to yield the required answer, e.g., the equivalent of £1000 in U.S. dollars when the rate is $4·15¼ is $4·1525 × 1000 = $4152·50.

The reverse applies with pence rates. For example, the equivalent of 5000 rupees at 1s. 6¼d. is 5000 × 1s. 6¼d. = £380 4s. 2d., while the equivalent of £850 at 1s. 6½d. per rupee is £850 ÷ 1s. 6½d. = Rupees 11027·03.

THE ACCOUNTS OF COLONIAL AND FOREIGN BRANCHES

Where branches are established in the colonies or in foreign countries, the system of accounts between the Head Office and its branches is based upon the same principles as those already outlined for home branches. But, even when branches are established in a dominion or colony, the currency of which is expressed in pounds (e.g., Australia, New Zealand, and South Africa), it is necessary to take into account the fact that the exchange rates are rarely at par, and that remittances between Britain and such countries can seldom be made at exactly equivalent rates. Hence, the local currencies must be treated exactly as though they were different units, i.e., the pound Australian merits similar treatment to the Swiss franc and the Canadian dollar, and suitable modifications must be made in the system of accounts in order to record necessary amounts expressed in local currencies and also any differences which arise through fluctuations in the rates of exchange.

It is, of course, essential that the Head Office books be kept in sterling, while it is equally necessary that the branch books be kept in local currency to correspond with the local conditions. In order to reconcile these two sets of records, it is more convenient for certain accounts in the Head Office books (including the Remittance Accounts to or from the branches and the Branch Account) to show details of the two currencies, and the ledger is, accordingly, ruled in the following manner :—

Dr. REMITTANCE ACCOUNT. *Cr.*

Date.	Particulars.	Fo.	Currency.	Rate of Exchange.	Sterling.	Date.	Particulars.	Fo.	Currency.	Rate of Exchange.	Sterling.
19..		C.B.	$		£ s. d.						
Jan. 1	To Cash	1	2814.00	4·02	700 0 0						

In the branch accounts, however, it is not so essential to show the two currencies, and, generally speaking, the books of foreign branches record the transactions in the local currencies only. The branch returns, therefore, will be submitted to the Head Office in currency, and the currency figures must be converted into sterling before they can be incorporated in the Head Office accounts.

Stable and Fluctuating Exchange Rates.

The rates of exchange of foreign currencies are classed either as "stable" or "fluctuating"; exchange rates are said to be "stable" when the amount of foreign currency which is exchangeable for the pound sterling does not vary to any great extent from time to time, and are described as "fluctuating" when the equivalent in sterling of the foreign unit, or alternatively, the equivalent of the pound sterling in the foreign units, is subject to considerable variation.

When the gold standard was in operation in Great Britain and the majority of other important countries, most of the principal exchange rates were practically stable, but since the departure of this country from the gold standard in September, 1931, all exchange rates with this country, with a few exceptions, may be described as "fluctuating." For the time being, therefore, the treatment outlined below in the case of branches situated in countries whose exchange rates are stable is, to all intents and purposes, of academic interest only, and the treatment advised in the case of fluctuating currencies will be applied even where, in normal circumstances, the exchange would be treated as stable (e.g. Canada, United States, etc.).

In the case of branches situated in countries whose exchange rates were stable, it was customary to convert all the branch accounts (with the single exception of the Remittance Account) at a fixed rate, such rate being a close approximation to the average rate ruling. Under this system, the Remittance Account was converted at the actual rates realised and all other accounts at the fixed rate. There would, of course, be a difference between the total sterling figures at the fixed rate and the conversions at the actual rate. This difference was a profit or loss on exchange, and it was credited or debited to an Exchange Account respectively, as shown in the example on page 508.

In the same example, the transfer of the difference in exchange is shown in the Remittance Account. An alternative method is to transfer the total amount realised for the remittances to the Branch Account, making the adjustment for the exchange in the Branch Account as shown in the further example on page 510.

Dr. REMITTANCES FROM PARIS BRANCH. *Cr.*

Date.	Particulars.	Fo.	Currency.	Ex.	Sterling.	Date.	Particulars.	Fo.	Currency.	Ex.	Sterling.
19..			Francs.		£ s. d.	19..			Francs.		£ s. d.
June 30	To Transfer to Branch Account . .	J.	182,555.00	25.20	7,244 4 11	Jan. 30	By Cash . .	C.B.	12,600.00	25.20	500 0 0
						Feb. 26	„ „ . . .	„	18,885.00	25.18	750 0 0
„ 30	„ Exchange Account . .	J.			5 15 1	Mar. 28	„ „ . . .	„	37,800.00	25.20	1,500 0 0
						Apl. 25	„ „ . . .	„	37,785.00	25.19	1,500 0 0
						May 30	„ „ . . .	„	12,585.00	25.17	500 0 0
						June 27	„ „ . . .	„	62,900.00	25.16	2,500 0 0
			182,555.00		£7,250 0 0				182,555.00		£7,250 0 0

Dr. EXCHANGE ACCOUNT. *Cr.*

						£ s. d.
				19.. June 30	By Remittance Account . . . . J.	5 15 1

NOTE.—In the above example the fixed rate has been taken (purely for purposes of illustration) at 25.20 francs to the £ sterling.

The following example shows a branch Trial Balance in currency, its conversion into sterling, and the accounts at Head Office and the branch :—

EXAMPLE.

At 31st December, 19.., the Trial Balance of the New York branch of a London firm was as follows :—

TRIAL BALANCE—31ST DECEMBER, 19..

	$	c.	$	c.
Cash at Bank	1,200	00		
„ in hand	100	50		
Stock at 31st December	6,000	50		
Machinery and Plant	5,000	75		
Remittances to London	500	00		
Sundry Creditors			10,500	75
Profit and Loss Account—Profit for year			1,586	00
Sundry Debtors	8,600	25		
Freehold Works and Offices	12,000	00		
Bad Debts Reserve			810	25
Furniture and Fittings	495	00		
Head Office Account—Balance as at 1st January			21,000	00
	$33,897	00	$33,897	00

The Cash remitted from New York was recorded in the head office books as £99, the actual amount realised by the remittances. Convert the above balances at the fixed rate of exchange of 5 dollars to the £, and give the New York Current Account as it should appear in the London books, and the Head Office Current Account as it should appear in the New York books.

The sterling Trial Balance will appear as follows :—

	£	s.	d.	£	s.	d.
Cash at Bank	240	0	0			
Cash in hand	20	2	0			
Stock at 31st December	1,200	2	0			
Machinery and Plant	1,000	3	0			
Remittances to London	99	0	0			
Sundry Creditors				2,100	3	0
Profit and Loss Account—Net Profit for year				317	4	0
Sundry Debtors	1,720	1	0			
Freehold Works and Offices	2,400	0	0			
Bad Debts Reserve				162	1	0
Furniture and Fittings	99	0	0			
Head Office Account—Balance at 1st January				4,200	0	0
Loss on Exchange	1	0	0			
	£6,779	8	0	£6,779	8	0

Head Office Books.

Dr. NEW YORK BRANCH ACCOUNT. Cr.

Date.	Particulars.	Fo.	Currency.	Ex.	Sterling.	Date.	Particulars.	Fo.	Currency.	Ex.	Sterling.
19..			$ c.		£ s. d.	19..			$ c.		£ s. d.
Jan. 1	To Balance . .	b/d.	21,000 00	5$	4,200 0 0	Dec. 31	By Remittances .		500 00		99 0 0
Dec. 31	„ Profit and Loss Account .		1,586 00	„	317 4 0	„ 31	„ Exchange Account				1 0 0
„ 31	„ Balance . .	c/d.				„ 31	„ Balance . .	c/d.			
	Sundry Creditors		10,500 75	„	2,100 3 0		Cash at Bank .		1,200 00	5$	240 0 0
	Bad Debts Reserve .		810 25	„	162 1 0		Cash in hand .		100 50	„	20 2 0
							Debtors . .		8,600 25	„	1,720 1 0
							Stock . . .		6,000 50	„	1,200 2 0
							Furniture and Fittings . .		495 00	„	99 0 0
							Machinery and Plant . .		5,000 75	„	1,000 3 0
							Freehold Works .		12,000 00	„	2,400 0 0
			$33,897 00		£6,779 8 0				$33,897 00		£6,779 8 0
19.. Dec. 31	To Balance Assets . \$33,397 00 *Less* Liabilities 11,311 00	b/d.	22,086 00	5$	4,417 4 0						

Dr. EXCHANGE ACCOUNT. Cr.

Date.	Particulars.	Fo.	Sterling.	Date.	Particulars.	Fo.	Sterling.
19..			£ s. d.	19..			£ s. d.
Dec. 31	To New York Branch . . .	J.	1 0 0	Dec. 31	By Profit and Loss Account . .	J.	1 0 0

New York Branch Books.

Dr. HEAD OFFICE ACCOUNT. *Cr.*

19..			$ c.	19..			$ c.
Dec. 31	To Remittances		500 00	Jan. 1	By Balance .		21,000 00
„ „	„ Balance .	c/d.	22,086 00	Dec. 31	„ Profit and Loss Account		1,586 00
			$22,586 00				$22,586 00
				Dec. 31	By Balance .	b/d.	22,086 00

The Exchange Account.

Where the balance of the exchange account is small, or small in comparison with the magnitude of the operations, the amount may be written off to the debit (or credit, as the case may be) of Profit and Loss Account. In the case of fluctuating currencies, however, where the variations are frequently considerable, the usual method adopted is to write off losses on exchange (i.e., a debit balance on the Exchange Account which will appear in the debit column of the converted trial balance, as a debit to Profit and Loss Account, and to carry forward a profit on exchange (i.e., a credit balance on the Exchange Account) as a reserve against possible future losses on exchange, this practice being in accordance with sound accounting principles.

Fluctuating Currencies.

Where rates of exchange fluctuate to any great extent during the trading period, it is not advisable to convert the branch currency figures at a fixed rate. The soundest and most equitable method, and that which is adopted by all reputable concerns, is to convert the various items, according to their nature, at varying rates. The accepted rules of conversion are:—

(1) Fixed Assets, at the original rate at which they were acquired less depreciation, i.e., at the same figure as they appear in the previous year's accounts, subject to the current year's charge for depreciation, which (when calculated on a percentage basis) should be converted at the rate applicable to the asset to which it relates.

Fixed assets purchased during the year are converted at the actual rate of a special remittance made for the purchase of the asset, or, alternatively, at the average rate for the year or the average rate ruling during the month in which the purchase was made.

(2) Fixed Liabilities, such as debentures or long term loans, at the rate ruling on the date when they were incurred. If, however, there has been a permanent fall in the exchange which will necessitate a larger amount of sterling being required when the liabilities come to be redeemed, it is suggested that a reserve should be built up gradually in the head office books to meet such increased liability.

(3) Floating Assets and Floating Liabilities are converted at the rate ruling at the date of the Balance Sheet.

(4) Revenue Items (or Balance of Profit and Loss Account) at the average rate for the period covered by the accounts. This average rate is obtained by taking the average of the actual rates for each week or month of the period. In exceptional cases, the rate for each day is taken for calculating the average.

(5) Opening Stock, at the rate ruling at the date of the previous Balance Sheet.

(6) Remittances at the actual rates at which the remittances were made, i.e., at the equivalent sterling amount shown in the head office Trial Balance.

(7) Goods to and from Branch at the equivalent sterling amount shown in the head office Trial Balance.

(8) Head Office Account at the sterling equivalent appearing in the Branch Account in the head office books.

After conversion is completed, the difference on exchange is debited or credited, as the case may be, to the Exchange Account. The balance of the latter account is dealt with as indicated on page 511.

It is a convenient practice for the Branch Trial Balance to be provided with three extra columns to show the rate of exchange and sterling amounts, as shown in the following example :—

BRANCH TRIAL BALANCE, as at........19..

Fo.	Account.	Currency.		Rate of Exchange.	Sterling.	
		Debits.	Credits.		Debits.	Credits.
		$ c.	$ c.		£ s. d.	£ s. d.

After conversion into sterling, the final accounts are prepared in the usual manner.

EXAMPLE I.

The Trial Balance of a Paris Branch of a London Company at 31st December, 19.., is as follows:—

	Francs.	Francs.
Head Office Account, 1st. Jan., 19..		451,373
Remittances to Head Office	236,062	
Fixtures and Fittings	26,040	
Sundry Debtors	171,288	
Stock at 1st. Jan., 19..	87,365	
Sundry Creditors		57,828
Purchases	186,989	
Sales		270,738
Cash Discount Allowed	4,183	
Cash Discount Received		5,429
Salaries	46,369	
Rent and Rates	20,826	
Bad Debts	2,403	
Cash in Hand	3,843	
	Fcs. 785,368	Fcs. 785,368

Stock, 31st December, 19.., Francs 91,866.

In the London books the balance on the Paris Branch Account at 1st January, 19.., was £5,218; and on 31st December, 19.., the balance on the Paris Remittance Account was £2,641; there was no cash in transit.

The rates of exchange were as follows:—

1st January, 19.., 86½; 31st December, 19.., 91½. At the date of purchase of the fixtures the rate was 124.

Prepare a converted Trial Balance for the Paris Branch, and write up the Paris Branch Account in the Head Office Books.

PARIS BRANCH, CONVERTED TRIAL BALANCE

As at 31st December, 19..

	Dr. Francs.	*Cr.* Francs.	Rate.	*Dr.* £	*Cr.* £
Head Office Account, 1st January, 19..		451,373	Actual		5,218
Remittances to Head Office	236,062		Actual	2,641	
Fixtures and Fittings	26,040		124	210	
Sundry Debtors	171,288		91½	1,872	
Stock at 1st January, 19..	87,365		86½	1,010	
Sundry Creditors		57,828	91½		632
Purchases	186,989		89	2,101	
Sales		270,738	89		3,042
Cash Discount Allowed	4,183		89	47	
Cash Discount Received		5,429	89		61
Salaries	46,369		89	521	
Rent and Rates	20,826		89	234	
Bad Debts	2,403		89	27	
Cash in Hand	3,843		91½	42	
Difference in Exchange				248	
	Fcs. 785,368	Fcs. 785,368		£8,953	£8,953

The net profit of the Paris Branch can be ascertained as follows:—

	£		£
Stock at 1st January 19..	1,010	Sales	3,042
Purchases	2,101	Stock at 31st December, 19.. (91,866 at 91½)	1,004
Cash Discount Allowed	47	Cash Discount Received	61
Salaries	521		
Rent and Rates	234		
Bad Debts	27		
Net Profit	167		
	£4,107		£4,107

PARIS BRANCH ACCOUNT.

Dr.					*Cr.*
19..		£	19..		£
Jan. 1	To Balance, *b/d.*	5,218	Dec. 31	By Remittances from Branch	2,641
Dec. 31	" Net Profit	167		" Loss on Exchange	248
				" Balance, *c/d.*	2,496
		£5,385			£5,385
19..					
Jan. 1	To Balance, *b/d.*— Fixtures and Fittings £210; Stock 1,004; Debtors 1,872; Cash 42; = 3,128; *Less* Creditors 632	2,496			

EXAMPLE II.

P. and Q. carry on business as General Merchants in London and have a Branch in Calcutta. Goods supplied by the Head Office to the Branch and *vice versa* are charged at cost, but the Branch also makes purchases direct from other suppliers in India and elsewhere. All items in the Branch Account in the Head Office books are converted at the rate of exchange ruling on the date of the transaction. The cost price in sterling of the fixed assets in Calcutta may be taken at an average rate of 1s. 6d. per rupee.

The following are the Trial Balances at 31st December, 1940:—

	Head Office.		Calcutta.	
	Dr.	*Cr.*	*Dr.*	*Cr.*
	£	£	Rs.	Rs.
Share Capital—Authorised and Issued (40,000 Shares of £1 each)		40,000		
Premises	20,000		35,000	
Fixtures and Fittings	2,250		2,000	
Calcutta Branch Account	11,500			
Calcutta Remittances Account		1,750		
Head Office Account				165,000
Head Office Remittances Account			24,000	
Purchases	23,000		379,000	
Sales		30,000		500,000
Expenses	4,000		80,000	
Sundry Debtors	3,500		60,000	
Sundry Creditors		1,500		25,000
Bills Receivable	1,550			
Bank and Cash Balances	1,450		15,000	
Stock at 1st January, 1940	6,000		95,000	
	£73,250	£73,250	Rs. 690,000	Rs. 690,000

Stocks at 31st December, 1940—London, £5,500; Calcutta, Rs. 97,500.

The rates of exchange have been:—

1st January, 1940	1s. 5d. per Rupee.
31st December, 1940	1s. 6d. „ „
Average for 1940	1s. 6d. „ „

Prepare Profit and Loss Account for the year and Balance Sheet at 31st December, 1940, for the Head Office and the Branch and for the whole business. Provide depreciation at 5% on the premises, fixtures and fittings. Reserve for doubtful debts, 5% on debtors at Head Office and 10% on those at Calcutta.

PROFIT AND LOSS ACCOUNT

For the Year ended 31st December, 1940.

Dr. | *Cr.*

	Head Office.	Calcutta.			Total.		Head Office.	Calcutta.			Total.
	£ s. d.	Rupees.	Rate.	£ s. d.	£ s. d.		£ s. d.	Rupees.	Rate.	£ s. d.	£ s. d.
To Stock at 1st Jan., 1940.	6,000 0 0	95,000	1s. 5d.	6,729 3 4	12,729 3 4	By Sales .	30,000 0 0	500,000	1s. 6d.	37,500 0 0	67,500 0 0
,, Purchases .	23,000 0 0	379,000	1s. 6d.	28,425 0 0	51,425 0 0	,, Stock at 31st Dec. 1940 .	5,500 0 0	97,500	1s. 6d.	7,312 10 0	12,812 10 0
,, Gross Profit, c/d. .	6,500 0 0	123,500	—	9,658 6 8	16,158 6 8						
	£35,500 0 0	Rs. 597,500		£44,812 10 0	£80,312 10 0		£35,500 0 0	Rs. 597,500		£44,812 10 0	£80,312 10 0
To Expenses .	4,000 0 0	80,000	1s. 6d.	6,000 0 0	10,000 0 0	By Gross Profit, b/d.	6,500 0 0	123,500		9,658 6 8	16,158 6 8
,, Depreciation— Premises .	1,000 0 0	1,750	1s. 6d.	131 5 0	1,131 5 0						
Fixtures and Fittings.	112 10 0	100	1s. 6d.	7 10 0	120 0 0						
,, Reserve for Doubtful Debts .	175 0 0	6,000	1s. 6d	450 0 0	625 0 0						
,, Net Profit.	1,212 10 0	35,650	—	3,069 11 8	4,282 1 8						
	£6,500 0 0	Rs. 123,500		£9,658 6 8	£16,158 6 8		£6,500 0 0	Rs. 123,500		£9,658 6 8	£16,158 6 8

BALANCE SHEET

As at 31st December, 1940.

Liabilities.	Head Office. £ s. d.	Calcutta. Rupees.	Rate.	£ s. d.	Total. £ s. d.
Share Capital. Authorised and Issued—40,000 Shares of £1 each .	40,000 0 0				40,000 0 0
Sundry Creditors .	1,500 0 0	25,000	1s. 6d.	1,875 0 0	3,375 0 0
Exchange Account .	429 3 4				429 3 4
Profit and Loss Account—					
Head Office	1,212 10 0				
Branch .	3,069 11 8				4,282 1 8
Head Office Account .		176,650		13,248 15 0	
	£46,211 5 0	Rs. 201,650		£15,123 15 0	£48,086 5 0

Assets.	Head Office. £ s. d.	Calcutta. Rupees.	Rate.	£ s. d.	Total. £ s. d.
Premises, *less* depreciation	19,000 0 0	33,250	1s. 6d.	2,493 15 0	21,493 15 0
Fixtures and Fittings, *less* depreciation	2,137 10 0	1,900	1s. 6d.	142 10 0	2,280 0 0
Stocks .	5,500 0 0	97,500	1s. 6d.	7,312 10 0	12,812 10 0
Sundry Debtors, *less* Reserve for Doubtful Debts .	3,325 0 0	54,000	1s. 6d.	4,050 0 0	7,375 0 0
Bills Receivable .	1,550 0 0				1,550 0 0
Bank and Cash Balances .	1,450 0 0	15,000	1s. 6d.	1,125 0 0	2,575 0 0
Branch Account .	13,248 15 0				
	£46,211 5 0	Rs. 201,650		£15,123 15 0	£48,086 5 0

NOTES.—(1) In view of the terms of the question, a converted Trial Balance of the Branch has not been shown, but details of the necessary conversion rates have been incorporated in the Profit and Loss Account and Balance Sheet.

(2) The profit on exchange is computed as follows :—

	Dr. Rupees.	£ s. d.	*Cr.* Rupees.	£ s. d.
Head Office Account (Actual) . .			165,000	11,500 0 0
Head Office Remittances Account (Actual) . .	24,000	1,750 0 0		
Stock at 1st January, 1940, at 1s. 5d. .	95,000	6,729 3 4		
Other Items at 1s. 6d.	571,000	42,825 0 0	525,000	39,375 0 0
Profit on Exchange .				429 3 4
	Rs. 690,000	£51,304 3 4	Rs. 690,000	£51,304 3 4

Non-trading Foreign Branches.

As in the case of home branches, there are certain types of foreign branches which do not trade independently ; their functions are usually confined to the development of an estate and the preparation of commodities for sale. Examples of this type of branch are tea and rubber estates, gold and tin mines, etc., although in some of these branches sales of their produce are effected locally.

Usually the branch is supplied from Head Office with monthly or other periodical remittances for the estate expenditure, and, where sales are effected locally, the funds received from Head Office are supplemented by the proceeds of such sales. As a general rule, however, the commodity produced is shipped to this country and sold by the Head Office.

The manager's books will consist of Journal, Cash Book and Ledger, in which suitable accounts are raised to record the various details of expenditure. A Head Office Account is opened and credited with remittances and any expenditure incurred on behalf of the branch by Head Office, e.g., in respect of machinery supplied. Periodically, the estate revenue accounts are closed by transfer to the Head Office Account, and thus the balance of the latter account will consist of—

(1) The capitalised expenditure on estate development.

(2) Fixed assets on the estate.

(3) Cash and other assets (if any).

Less

(4) Local sundry liabilities.

A monthly summary of the branch accounts is transmitted to the Head Office, accompanied by a copy of the branch cash book ; certificates of cash and bank balances ; and a statement

showing the quantity of the commodity produced, shipments for the month, and balance in store. In many cases a certified copy of the bank pass book also is sent.

The branch returns form the basis of the entries in the Head Office books, and, in many cases, the Head Office journals, as well as ledgers, are ruled to accommodate both the currency and the sterling figures. The practice as to conversion varies, sometimes it is done monthly, but in other cases only the currency figures are posted each month to the estate ledger, and conversion is deferred until the end of the trading period. This, however, is a point of practice upon which opinions may legitimately differ.

When the final branch returns for the trading period are entered in the Head Office books, the latter will record all the accounts necessary for the preparation of the final accounts, which are then compiled in the ordinary manner.

With this type of branch difficult questions sometimes arise as to the correct basis for the apportionment of the expenditure between capital and revenue. A discussion of this question, however, is beyond the scope of this volume, and, moreover, it can be decided satisfactorily only after an investigation into the circumstances of each case.

EXERCISE 12.

A. The Birmingham branch books of Walton & Co., of Manchester, dealers in a patent office appliance, were made up to 31st March, when the Trial Balance was as follows:—

	£	£
Sundry Debtors	3,000	
Sales Account		2,500
Cash in hand	60	
Head Office Account		1,700
Trade Expenses	1,040	
Fixtures, Furniture, etc.	100	
	£4,200	£4,200

The stock of appliances at Birmingham, on 31st March, amounted to £300. Show the journal entries necessary to close the branch books, and in order to incorporate the above in the Head Office books, give the entries which you would make.

B. The Electolite Manufacturing Company invoice goods to their Barnsley branch at $33\frac{1}{3}\%$ on cost, and the branch sales are exclusively cash. All branch expenses are paid by the Head Office. From the following particulars write up the Branch Account in the Head Office books:—

	£	s.	d.
Goods sent to Branch	3,600	7	8
Wages and Salaries paid	190	6	4
Cash remitted by Branch	3,534	7	9
Stock, 1st January	450	6	4
Rates, Telephone, etc.	42	11	11
Sundry Trade Charges	21	5	10
Rent paid	75	5	3
Stock at 31st December	510	9	2

C. X & Y are the owners of a number of shops in various districts. The managers at each shop have discretion to give credit for a period not exceeding two months.

The owners desire to have each month a statement showing the position of the book debts compared with the turnover for which credit is given. To save the trouble and expense of preparing each month a list of debtors, what method would you suggest for obtaining the information?

D. The Acme Provision Co., Ltd., has a retail branch in Newcastle which is supplied with all goods from London. The branch shop keeps its own sales ledger, receives cash against ledger accounts, and remits the whole of the cash received daily to the Head Office. All wages and branch expenses are drawn for by cheque weekly from the Head Office upon the imprest system.

From the undermentioned particulars supplied by the branch manager, show how the branch accounts would appear in the Head Office books, and prepare a Profit and Loss Account for the branch shop for the six months to 31st December.

	£
Six months' Credit Sales	2,387
Returns Inwards	20
Cash received on Ledger Accounts	2,384
Cash Sales	1,214
Stock, 1st July	720
Stock, 31st December	1,121
Debtors, 1st July	1,227
Goods received from Head Office	2,178
Rent, Taxes, etc., paid	375
Wages and Sundry Expenses paid	396

E. Messrs Richmond, Bond & Co., Ltd., London, have a branch office in a South American Republic, where the exchange fluctuations are considerable. The books of the branch are kept in local currency only, and, at the close of each financial year, a Trial Balance, Profit and Loss Account, and Balance Sheet are sent to the London office.

Briefly describe how you would amalgamate the branch figures with those of the Head Office.

At what rates would you convert (1) the Profit and Loss Account balance, (2) the floating assets, (3) the fixed assets, and (4) remittances from London?

F. The Universal Tobacco Company, Limited, proposes to open 20 retail shops in various towns for the sale of (*a*) Cigarettes, (*b*) Tobacco, and (*c*) Pipes and Sundries.

All goods are to be supplied from a central warehouse in London. No local purchases of goods are to be allowed.

You are required to draft instructions for the Head Office book-keeper:—

(*a*) As to the records to be kept in the Head Office books regarding goods forwarded to the branches.
(*b*) As to the returns to be made to the Head Office by the branches, and
(*c*) As to the best method of dealing with cash payments for expenses paid locally.

G. Describe how you would treat the accounts of branches in the Head Office books of a multiple shop firm.

H. A company owning 500 branch shops instruct you to prepare a suitable system of accounts. Simplicity is of the first importance, as the knowledge of accounts of the branch managers is very limited. The company deal in five main commodities and sundries.

You are instructed to prepare forms of accounts, so that weekly Profit and Loss Accounts may be prepared, continuous stocks kept, and cost accounts giving quantities for each branch. Give—

(*a*) Form of accounts to be kept at each shop.
(*b*) Weekly accounts to be forwarded to the Head Office.
(*c*) Head Office book of statistics.

I. The Pandora Manufacturing Company, Limited, has a Nominal Capital of 15,000 Shares of £10 each; and a Subscribed Capital of 8,000 Shares, fully paid up. It manufactures goods for sale at its two branches, A and B, which sell no goods other than those of the company's manufacture. From the following Trial Balance, extracted from the books of the Head Office and branches as on 31st December, 1940, prepare, for submission to the directors, Trading and Profit and Loss Accounts for the Head Office and for each of the branches for the year ended 31st December, 1940, and a Balance Sheet of the company as a whole as on that date.

NOTES:

Stocks on hand valued as on December 31st, 1940, were :—

	£
Head Office	10,527
Branch A	3,025
,, B	1,927

Write off the following depreciations :—

Head Office Plant and Machinery	10%
Furniture and Fixtures, Head Office	5%
,, ,, Branch A	5%
,, ,, Branch B	5%

Create a reserve for Bad Debts of $2\frac{1}{2}\%$ on the Sundry Debtors. Write off £5,000 from Goodwill and carry £10,000 to Reserve. All carriage on the goods sent to the branches is paid by the Head Office. The salaries include £500 paid to the secretary, who is also a director, as remuneration for his work as secretary.

The Pandora Manufacturing Company Limited

TRIAL BALANCE

AS AT 31ST DECEMBER, 1940

	Dr.			*Cr.*		
	Head Office.	Branch A.	Branch B.	Head Office.	Branch A.	Branch B.
	£	£	£	£	£	£
Freehold Premises at valuation :—						
Head Office	40,000					
Branch A	10,000					
Branch B	10,000					
Goodwill at cost	30,000					
Plant and Machinery, Head Office, at cost, less depreciation	8,000					
Furniture and Fixtures at valuation :—						
Head Office	500					
Branch A	700					
Branch B	800					
Cash at Bank	6,790					
Cash in hand	14	83	38			
Stock in hand, 1st January, 1940	11,245	2,812	1,995			
Purchases (less Returns)	65,090					
Wages	39,661	2,419	2,622			
Salaries	1,500	248	276			
Carriage to Branches	1,517					
Rates and Taxes	323	442	329			
General Expenses	517	2,016	1,796			
Goods from Head Office		94,167	44,267			
Bad Debts		1,553	747			
Sundry Debtors		9,620	5,370			
*Income Tax	448					
*Directors' Fees	1,000					
*Audit Fee	105					
Branch A Current A/c.	302					
,, B ,,	3,353					
Share Capital				80,000		
Sundry Creditors				11,247	541	547
Goods to Branch A				94,167		
,, ,, B				44,267		
Sales (less Returns)					112,517	53,540
Profit and Loss Account (Balance)				2,174		
Head Office Current Account					302	3,353
	£231,855	£113,360	£57,440	£231,855	£113,360	£57,440

* No apportionment of these items need be made.

J. The rates of exchange ruling between this country and other countries are described either as "stable" or "fluctuating." Describe what these expressions mean, and briefly explain any differences which are necessary in the book-keeping records of dealings of the above types between this country and other countries.

K. When auditing the books of a London firm with branches abroad, you find that journal entries have been made incorporating returns from foreign branches at various rates of exchange.

To what sources should you refer in order to satisfy yourself that the rates of exchange adopted are reasonable ?

L. Messrs Mong & Pradit, Ltd., of Madras, the agents of Messrs Winson & Co., Ltd., London, advise their principals that the net profits for the six months ending 30th June, 19.., amount to Rupees 150,000, of which they remitted the following sums :—

May 16th. Rs. 50,000 @ 1s. $4\frac{1}{16}$d.
July 10th. Rs. 50,000 @ 1s. $4\frac{1}{32}$d.
Sept. 1st. Rs. 50,000 @ 1s. $3\frac{31}{32}$d.

Messrs Winson & Co., Ltd., calculate the exchange at the uniform rate of 1s. 4d. to the Rupee, and write off any differences to an Exchange Account. Write up Winson & Co.'s Cash Book, Journal, and Ledger, showing Mong & Pradit's Account, Profit and Loss Account, and Exchange Account (writing off any balance to Profit and Loss Account).

M. Messrs Bladwin, Ball & Co., Ltd., operate in London, Manchester, and New York. The following are the Trial Balances on 31st December. The rate of exchange used for book-keeping purposes is 4.80 dollars to the £. Prepare a Balance Sheet showing Bladwin, Ball & Co.'s position at that date.

LONDON.

	£	£
Share Capital		100,000
Debentures		50,000
New York Branch		30,000
Manchester Branch	80,000	
Reserve Fund		20,000
Cash	40,000	
Debtors	127,000	
Creditors		30,000
Office Furniture	1,000	
Profit and Loss Account		18,000
	£248,000	£248,000

MANCHESTER.

	£	£
Head Office		80,000
Debtors	15,000	
Creditors		2,000
Cash	4,000	
Office Furniture	500	
New York Office	60,000	
Loans	10,000	
Profit and Loss Account		7,500
	£89,500	£89,500

NEW YORK.

	$	$
Head Office	144,000	
Manchester Office		288,000
Bank Overdraft		120,000
Cash in hand	1,000	
Debtors	275,200	
Creditors		1,000
Office Furniture	2,000	
Profit and Loss Account		13,200
	$422,200	$422,200

N. A. Moore & Co., whose Head Office was in London, had a branch establishment at Paris. Owing to losses experienced it was decided to close the branch and transfer the stock to London. The following figures represent the Balance Sheets of the two houses on 30th June, 19..

LONDON BALANCE SHEET.

Liabilities.	£	*Assets.*	£
Capital	40,000	Buildings	8,000
Creditors	5,000	Debtors	13,500
Profit and Loss Account	3,500	Bank	500
		Cash	100
		Paris Branch	5,000
		Stock	21,400
	£48,500		£48,500

PARIS BRANCH (in francs).

Creditors	10,000	Debtors	60,000
Head Office	125,500	Cash	1,000
		Bank	5,700
		Fixtures	7,800
		Stock	61,000
	Fcs. 135,500		Fcs. 135,500

A fixed rate of exchange, 25.10, had been used between the Head Office and branch, and the branch stock was taken over by the Head Office at this rate. The Paris debtors realised 45,000 francs, and the fixtures were sold for 4,500 francs. Creditors were paid in full, and the cost of winding up the branch was 1,000 francs. The proceeds of the realisation, including cash in hand and bank, were transmitted to London at the rate of 27.25. You are required to show the closing transactions in the Paris books, the Paris Branch Account and adjusted Profit and Loss Account in Head Office books, and also to reconstruct the Head Office's Balance Sheet by including the results of the realisation.

O. A company, of which you are auditor, has a branch in New York. All the accounts relating to the branch are kept there, and are audited by New York accountants, who transmit yearly accounts to the Head Office in England, where they are incorporated with the English accounts.

The American branch is merely a selling branch, and the assets consist of Land and Buildings, Fixtures and Fittings, Stock-in-Trade (consisting of goods sent from England, which are invoiced at a fixed rate), and Sundry Debtors.

How should the American accounts be incorporated in the English books ?

P. On 30th January, 19.., Exporters, Ltd., sold to Muno and Lejos, of Lisbon, goods valued £500, which were invoiced in escudos at the rate of 110. On 1st May, 19.., a draft on the Portuguese Bank was received in payment less a discount of 3%. This was handed to the bankers of Exporters, Ltd., for collection, and on 6th May, 19.., their account was credited with the proceeds at the rate of 109½.

Show how these transactions would be recorded in the books of Exporters, Ltd., and state how any difference on exchange arising in such a business should be treated.

CHAPTER XIII

MISCELLANEOUS ACCOUNTS

MANAGER'S COMMISSION ON NET PROFITS—RECEIPTS AND PAYMENTS ACCOUNT—INCOME AND EXPENDITURE ACCOUNT—INTERIM STOCK ACCOUNTS—APPROXIMATE PROFIT AND LOSS ACCOUNTS — ROYALTIES — HIRE-PURCHASE ACCOUNTS — MAINTENANCE AND REPAIRS AGREEMENTS — VOYAGE ACCOUNTS — STEAMSHIP COMPANIES' INSURANCE FUNDS — INVESTMENT ACCOUNTS —LIFE POLICY TAKEN IN SETTLEMENT OF A DEBT—PROPERTY COMPLETION ACCOUNTS — COMPENSATION CLAIMS—SOLICITORS' ACCOUNTS.

IN the present chapter it is proposed to discuss several minor phases and problems which arise in connection with accounts. The word "minor" is used in a relative sense, inasmuch as the matters dealt with do not involve any new principles. Nevertheless, they are by no means unimportant, and they are matters which merit—and must receive—careful attention from those who desire to attain a reasonably complete knowledge of accounting methods.

MANAGER'S COMMISSION ON NET PROFITS

It is quite a common practice for the terms of appointment of managers or managing directors to provide that these persons are entitled to a commission at a given rate per cent. on the balance of profits remaining after such commission has been charged. In such circumstances, the net profits may be said to consist of that total number of parts represented by 100 plus the agreed rate per cent., i.e., the amount of remuneration may be calculated by using the following formula :—

$$\frac{\text{Rate per cent.} \times \text{Profits prior to charging percentage}}{(100+\text{Rate per cent.})}$$

Thus, assuming the rate to be 5 per cent., the total number of parts into which the net profit is divided will be $100+5=105$, and the manager will be entitled to five of such parts. If the total net profits are £3,465, the manager's commission is arrived at in the following manner :—

$$\frac{5}{105} \text{ of } £3{,}465=£165.$$

The remaining balance of profits is £3,300, and if 5 per cent. on that figure is calculated, the resultant amount is £165, thus proving the accuracy of the method.

It should be noted that net profit being a very indefinite term, the agreement of appointment should state in the clearest possible terms the manner in which the profits are to be ascertained. *In the absence of any agreement to the contrary*, " net profit " means the increase of the net assets over a stated period, after allowing for any capital introduced or withdrawn. Consequently, all debits and credits to Profit and Loss Account should remain when calculating the commission. Income Tax, however, is an *appropriation* of profits, and must therefore, in the absence of any agreement to the contrary, be eliminated before the commission is calculated. (*Johnston* v. *Chestergate Hat Manufacturing Co.*, 1915).

If the agreement provides for the commission to be computed on *Trading Profits*, only items of a trading nature must be left in the Profit and Loss Account when ascertaining the profit on which the commission is to be calculated.

EXAMPLE

Before charging commissions to the Manager and Directors, the following is the Profit and Loss Account of Y. Co. Ltd. :—

PROFIT AND LOSS ACCOUNT

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 1941. *Cr.*

	£		£
To Expenses	13,150	By Gross Profit . . .	24,000
„ Income Tax . .	5,000	„ Dividends (after deducting tax at 10s. 0d.) .	575
„ Balance	6,425		
	£24,575		£24,575

The agreement with the Manager provides that he is to receive 4% on the net trading profits *before* charging his commission, and the Directors' agreements provide for commission (which is to be regarded as a trading expense) at 2% on the net profits *after* charging both commissions. Calculations are to be made to the nearest £.

It is apparent that the directors' commission must be charged before computing the manager's commission, since it is to be regarded as a trading expense. Apart from this, the *net trading profits* are computed :—

	£
Net Profit, per Profit and Loss Account	6,425
Add Income Tax	5,000
	11,425
Less Dividends	575
	£10,850

Similarly, the directors' commission must be computed after charging both manager's and directors' commissions. The dividends will remain as a credit

to the account, but all income tax (including that deducted from dividends) must be added back.

Apart from the deductions for commissions, the net profits are :—

	£
Net Profit, per Profit and Loss Account	6,425
Add Income Tax	5,000
Tax deducted from dividends	575
	£12,000

CALCULATION OF COMMISSIONS.

Let x = Directors' Commission
and y = Manager's Commission

$$x = 2\% \text{ of } (£12{,}000 - x - y)$$
$$x = \tfrac{2}{100} \times (£12{,}000 - x - y)$$
$$50x = £12{,}000 - x - y$$
$$\therefore\ y = £12{,}000 - 51x \quad (\textit{substituted below})$$

$$\text{and } y = 4\% \text{ of } (£10{,}850 - x)$$
$$y = \tfrac{4}{100} \times (£10{,}850 - x)$$
$$25y = £10{,}850 - x$$

Substituting equation above :—

$$25(£12{,}000 - 51x) = £10{,}850 - x$$
$$£300{,}000 - 1275x = £10{,}850 - x$$
$$x = £227 \text{ (to nearest £)}$$

$$\therefore\ y = 4\% \text{ of } (£10{,}850 - £227)$$
$$= £425 \text{ (to nearest £)}.$$

The amount of directors' commission (£227) may be proved :—

	£	£
Profits, as above		12,000
Less Manager's Commission	425	
Directors' Commission	227	
		652
Net Profits		£11,348
2% on £11,348	=	£227

RECEIPTS AND PAYMENTS ACCOUNTS, AND INCOME AND EXPENDITURE ACCOUNTS

A RECEIPTS AND PAYMENTS ACCOUNT is a statement of cash actually received and paid during a given period, receipts being debited and payments credited. It is, in effect, a summary of the Cash Book, and therefore shows the opening and closing balances of cash in hand, and receipts and payments of any kind and on any account made during the period. Where the receipts and payments are numerous, the compilation of this account is facilitated by the use of a Columnar Cash Book, containing analysis columns for the more usual items.

An account in this form will frequently give to an uninitiated person a wrong impression of the financial position of the undertaking concerned, since no distinction is made between capital receipts and payments, and receipts and payments on

account of revenue. Further, cash alone is dealt with, outstanding expenses or income due but not received being ignored, while outstanding debtors and creditors (if any), at the beginning and end of the period, are not included in the account.

An Income and Expenditure Account includes on the credit side the entire income of an undertaking for the period under review, whether actually received or not; and on the debit side, the whole of the revenue expenditure properly chargeable against such income, whether actually paid or not. The balance of the account shows the excess of income over expenditure, or *vice versâ*.

This form of account is generally made use of by non-trading concerns such as clubs, charities, etc., and corresponds to the Profit and Loss Account of a trading concern. It should be accompanied by a Balance Sheet showing the financial position at the close of the period.

It will thus be seen that there are important and fundamental differences between a Receipts and Payments Account and an Income and Expenditure Account. The main difference between the two accounts lies in the fact that one is drawn up to show the closing cash balance or deficit and the other to show the excess of income over expenditure, or *vice versâ*. Furthermore, an Income and Expenditure Account forms an essential part of the double entry system in the same way as a Profit and Loss Account, and is usually accompanied by a Balance Sheet, whereas a Receipts and Payments Account is merely a memorandum statement.

As an illustration of the difference between these classes of account, we may consider the case where a sum is received by the Governors of a school as a fund for investment, out of which yearly prize bonuses are to be provided. An Income and Expenditure Account would show the yearly appropriation from the fund of the requisite amount, as a credit item, and the actual payment or liability to the successful scholars, as a debit item. On the other hand, a Receipts and Payments Account would necessarily include, in the accounts for the year in which it was received, the whole of the original sum received, and no apportionment would be possible in that account in respect of amounts which would need to be dealt with in future years.

In order to convert a Receipts and Payments Account into an Income and Expenditure Account, it is necessary to—

(1) Eliminate all capital receipts and payments.
(2) Exclude amounts of a revenue nature which relate to succeeding and preceding periods.
(3) Include revenue income and expenditure relating to the period under review, but not received or paid during that period.
(4) Bring into account reserves for bad debts, depreciation, etc., which affect the profit.

EXAMPLE.

The undernoted "Receipts and Payments Account" of the "Albany Athletic Society" is for the year ended 31st December, 19.. Other ledger balances of the Society are :—

	£	s.	d.
Capital Account (Donations, etc.)	3,025	0	0
Club House and Grounds (as per valuation) . .	2,000	0	0
Investments at cost	962	0	0
Furniture and Fixtures	320	0	0
Income and Expenditure Account (*Cr.* Balance brought forward)	296	10	0

RECEIPTS AND PAYMENTS ACCOUNT.

Dr. FOR YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

		£	s.	d.			£	s.	d.
To Balance at 1st Jan.	*b/d.*	74	10	0	By Upkeep of Grounds (*a*) . . .		475	0	0
„ Annual Sub., Albany Mfg. Co.		210	0	0	„ Wages of Groundsmen . .		468	0	0
„ Subscriptions .		470	0	0	„ Ground Rent .		10	10	0
„ Entrance Fees .		26	5	0	„ Printing and Stationery (*b*) .		46	10	0
„ Interest on Investments—(net) .		42	0	0	„ Postages and Sundries . .		9	10	0
„ Proceeds of Lectures, Concerts, etc. . . .		258	15	0	„ Balance . .	*c/d.*	72	0	0
		£1,081	10	0			£1,081	10	0
To Balance . .	*b/d.*	72	0	0					

(*a*) This item includes £25 applicable to the previous year
(*b*) „ „ £10 „ „ „

The outstanding items at 31st December, 19.., are :—

Printing and Stationery, £8; the Delta Literary Association owed £10 10s. for the use of the Society's Hall; two members' subscriptions of £5 each were in arrear.

Charge 10% for depreciation on Furniture and Fixtures.

Construct the Income and Expenditure Account for the year, and Balance Sheet as at 31st December, 19..

INCOME AND EXPENDITURE ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

Expenditure.	£	s.	d.	*Income.*	£	s.	d.
To Upkeep Grounds. .	450	0	0	By Annual Sub., Albany Mfg. Co. .	210	0	0
„ Wages . . .	468	0	0	„ Subscriptions . .	480	0	0
„ Ground Rent . .	10	10	0	„ Interest on Investments—(net) . .	42	0	0
„ Postages and Sundries .	9	10	0	„ Lectures, Concerts, etc.	258	15	0
„ Printing and Stationery	44	10	0	„ Letting of Hall . .	10	10	0
„ Depreciation on Furniture and Fixtures .	32	0	0	„ Balance — Excess of Expenditure over Income . . .	13	5	0
	£1,014	10	0		£1,014	10	0

BALANCE SHEET OF THE ALBANY ATHLETIC SOCIETY.

As at 31st December, 19..

Capital and Liabilities.			£ s. d.	*Assets.*		£ s. d.
Capital Account . .			3,025 0 0	Cash at Bank . . .		72 0 0
Add Entrance Fees .			26 5 0	Investments . . .		962 0 0
				Sundry Debtors . .		10 10 0
			3,051 5 0	Debtors for Subscriptions		10 0 0
					£ s. d.	
Income and Expenditure Account—				Furniture and Fixtures—	320 0 0	
As at 1st Jan. 19.. .	£ s.	296 10		*Less* Depn. .	32 0 0	
Less Excess of Expenditure over Income for Year .		13 5				288 0 0
			283 5 0	Club House and Grounds		2,000 0 0
			3,334 10 0			
Sundry Creditors . .			8 0 0			
			£3,342 10 0			£3,342 10 0

It will be observed that the Income and Expenditure Account is prepared by adjusting the actual cash received and paid (as shown in the Receipts and Payments Account), for outstanding debtors and creditors. The Printing and Stationery Account would appear as follows, other accounts being dealt with in a similar manner :—

Dr. PRINTING AND STATIONERY. *Cr.*

19..			£ s. d.	19..			£ s. d.
Dec. 31	To Cash . .		46 10 0	Jan. 1	By Balance . .	*b/d.*	10 0 0
	„ Balance . .	*c/d.*	8 0 0	Dec. 31	„ Income and Expenditure Account .		44 10 0
			£54 10 0				£54 10 0
				Dec. 31	By Balance . .	*b/d.*	8 0 0

In the above example, Entrance Fees have been regarded as a capital receipt and added to the balance of the Capital Account. It is, however, quite usual for societies to show their balances on both capital and revenue accounts in one item in the Balance Sheet, under the general heading "Accumulated Fund." If this practice had been followed by the above Society, the Entrance Fees would have been credited to Income and Expenditure Account, thus converting the deficit into a surplus of £13, and

the left side of the Balance Sheet would have comprised only the following two items :—

	£ s. d.	£ s. d.
Accumulated Fund :—		
Balance at 1st January, 19.. . . .	3,321 10 0	
Add Excess of Income over Expenditure for Year	13 0 0	
		3,334 10 0
Sundry Creditors		8 0 0
		£3,342 10 0

Furthermore, it is the practice of some societies to apportion entrance fees and life membership subscriptions over a short term of years, and to credit an agreed proportion to revenue annually. The balance of such items is carried forward in suspense in the Balance Sheet.

INTERIM STOCK ACCOUNTS

In the case of departmental stores and multiple shops, where the average gross profit on sales of each department or shop is fixed at a standard rate, it is usual to keep a weekly statistical record of estimated stock accounts and to take stock at irregular intervals, so that a comparison of the actual and estimated stock can be made, and a general check maintained upon the departmental managers and shop managers.

The method adopted is to add to the commencing stock the weekly purchases or deliveries, and, after reducing sales to cost price, to deduct the resulting amount; the figure thus obtained is the estimated amount of stock which should be in hand.

The form of the weekly statistical stock account (which is purely a memorandum account and quite distinct from the ordinary accounts) is as follows :—

STATEMENT OF STOCK.

For the Week ending 8th January, 19..

	A. Department. Average Rate of Profit =25% on S.P.		B. Department. Average Rate of Profit =20% on S.P.	
	£	£	£	£
Commencing Stock at C.P. .		3,200		2,100
Purchases		790		540
		3,990		2,640
Sales at S.P.	900		820	
Less Estimated Profit . .	225	675	164	656
Estimated Stock at C.P. . .		£3,315		£1,984

As previously stated, stock is taken at irregular intervals, and the value of the actual stock as ascertained is compared with the estimated stock. Small differences are adjusted, as they are probably due to slight variations in the rate of profit earned, but the reason for any large discrepancy should be ascertained and steps taken to eliminate the causes thereof.

It should be noted, however, that this system can be satisfactorily applied only when—

(1) The rate of profit does not vary, or varies between narrow limits.

(2) Stock is taken at frequent intervals.

(3) Wastage or loss from damage is small, and accurate records are taken of such losses.

Moreover, the accuracy of the estimated stock is entirely dependent upon the accuracy of the figures for the respective items in the statistical stock account. Any error in the figures of the component items must necessarily be repeated in the final figure for the estimated stock.

In the case of retail shops where the goods are charged out by Head Office at selling price, the statistical stock account is compiled on the basis of sale price.

An important advantage of maintaining these stock accounts is that the proprietors of the business are enabled to watch closely the value of stock held, with the twofold object of preventing any undue increase or decrease, and of seeing that the stock actually carried is fully covered by insurance.

APPROXIMATE PROFIT AND LOSS ACCOUNTS

The statistical stock accounts discussed in the preceding paragraphs really form approximate trading accounts, and in a similar way, estimated profit and loss accounts may be compiled periodically, with the object of closely watching the progress of the business, and supervising particularly the ratio of the expenses to the profits.

To achieve these objects the Nominal Ledger must be arranged on a self-balancing basis, and a weekly or monthly trial balance must be extracted. The trial balance should show the figures for the period concerned as well as the aggregate totals to date, in the manner indicated in the following example :—

NOMINAL LEDGER TRIAL BALANCE.
15TH JANUARY, 19..

Account.	Week Ending 15th January, 19..		Total to Date. 15th January, 19..	
	Dr. £	Cr. £	Dr. £	Cr. £
Rent, Rates, and Taxes	36		72	
Wages	132		269	
Salaries	45		90	
Discounts	63		119	
Expenses	54		112	
Adjustment Account		330		662
	£330	£330	£662	£662

The figures contained in the above statement will form the basis for the compilation of the approximate Profit and Loss Accounts. For certain classes of expenditure which are payable quarterly or half-yearly, e.g., Rent, Rates, Taxes, Insurance, Directors' Fees, etc., the weekly amounts must be calculated. To obtain the utmost value from these approximate accounts, each item should be shown as a percentage to the gross turnover, as in the following statement :—

APPROXIMATE PROFIT AND LOSS STATEMENT.
WEEK ENDING 15TH JANUARY, 19..

	Percentage.	Week Ending 15th January, 19..		Percentage.	Total to Date, 15th January, 19..	
		£	£		£	£
Sales			1,800			3,400
Estimated Gross Profit	25%		£ 450	25%		£ 850
Rent, Rates, and Taxes	2·00	36		2·12	72	
Wages	7·33	132		7·91	269	
Salaries	2·50	45		2·65	90	
Discounts	3·50	63		3·50	119	
Expenses	3·00	54		3·29	112	
	18·33		330	19·47		662
Estimated Net Profit	6·67		£120	5·53		£188
	25·00			25·00		

At the close of each trading period, the figures given in these approximate statements should be compared with those given in the actual final accounts, and any discrepancy examined

with a view to ascertaining its cause and preventing, as far as possible, similar discrepancies in future statements.

ROYALTIES

From a commercial view-point, the term "Royalty" is used to denote the monetary payment made for the right to exercise certain privileges or monopolies, as for example :—

(1) The right to extract coal, clay, or minerals from land ;
(2) The right to use and apply certain patents ; or
(3) The right to publish books or musical works.

The book-keeping entries required for the last two classes are quite simple. In the user's books, the owner of the patent or copyright is credited with the amount of the royalty. The debit entry in the first instance is made to Patent Royalties Account or Copyright Royalties Account, the balance of such account being subsequently transferred to the Profit and Loss Account as an expense incurred during the trading period. The entries in the owner's books will be the reverse of those indicated, as the royalties are, of course, part of his profits or income

Where, however, the inventor of a patent, the author of a book, or the composer of a musical work disposes of his entire rights for a lump sum, the patent or other rights become the absolute property of the purchaser and no royalties are payable. In this case the purchaser will debit an asset account with the amount paid, and this amount will appear in the Balance Sheet, subject to any amount written off for depreciation.

The payment of the first class of royalties referred to above, viz., those in respect of the mining of coal, clay, or minerals, usually conveys two distinct rights—

(1) The right of tenancy of the land ; and
(2) The right to extract and take away certain valuable constituents of the land, either on the surface or underground.

Frequently, however, as in the case of the mining of coal under property, there is no question of tenancy of the land, but royalties must nevertheless be paid to the owner of the land in respect of mineral extracted from his property.

Dead Rent.

The payment to the ground landlord customarily takes the form of a minimum yearly rent, merging into a royalty of so many pence per ton of the coal, clay, or other mineral extracted or "gotten" from the land, when the royalty at the agreed rate on the amount extracted is more than enough to cover the

minimum yearly rent. For example, it may be agreed to pay 3d. per ton on all coal removed from a mine under a certain area, with a minimum annual payment of £200 ; if, for instance, only 4,000 tons are mined, the royalty is £50, but the landlord must be paid the minimum £200.

The amount of the royalty per ton may vary according to the quality of the mineral or its market price, or it may be based upon the footage of coal worked or upon the area of the land under which the mines extend.

The minimum yearly rent is payable irrespective of whether the mine is worked or not, and thus the landlord is assured of a certain regular income. This minimum rent is variously known as *Dead Rent*, *Certain Rent*, *Fixed Rent*, etc.

Short Workings.

When the tonnage of the output is less than that necessary to cover the minimum rent at the rate of royalty payable under the lease, the difference is termed "Short Workings," the term being applied to indicate the tonnage short worked as well as its monetary value, e.g., if the minimum rent is £200 per annum, and the royalty 3d. per ton, then 16,000 tons must be worked before the royalty is covered. If only 4,000 tons are worked, the "short workings" are 12,000 tons, or, in value, £150.

The proper development of a mine during the early years of its existence is usually a very slow and expensive process, and, consequently, it is frequently agreed that a nominal rent only shall be payable for the first two or three years. More generally, however, the lease contains clauses providing for the payment of a minimum rent, but allowing the lessee to set off the short workings of the development period against the larger output of later years, when the royalties payable are in excess of the minimum rent. Such clauses convey what is known as the "right to recoup short workings," and, usually, this right extends over only the first few years of the lease.

Recording Royalties and Short Workings.

The methods of recording these royalties and short workings in books of account may be summarised thus—

(1) The debit to Royalty Account (which is ultimately transferred to Profit and Loss Account) must represent the agreed royalty on the actual output, whether short workings occur or not.

(2) The minimum rent is payable in any case, and in those years where the tonnage worked does not reach this figure, the amount of the minimum rent payable is debited to Minimum Rent Account and credited to the Landlord. The Landlord's Account is cleared upon payment.

(3) The royalty on tonnage worked is debited to Royalty Account and credited to Minimum Rent Account, the balance of the latter account being transferred to Short Workings Account. If there is a right to recoup short workings, the Short Workings Account is treated as an asset and appears as such in the Balance Sheet.

(4) For those years in which the royalty on output exceeds the minimum rent, there is no necessity to open an account for the latter, the better method being to debit the Royalty Account and credit the Landlord direct with the full amount of royalty on the tonnage produced.

(5) Where a debit balance exists in the Short Workings Account and the royalties exceed the minimum rent, the royalty on the excess tonnage is debited to the Landlord and credited to Short Workings Account. This process is repeated each year there is excess tonnage until the Short Workings Account is extinguished. Where, however, the lease provides that the right of recovery exists only for a certain period, at the end of that period any balance to the debit of Short Workings Account must be written off to the Profit and Loss Account.

These principles are illustrated in the following example :—

EXAMPLE.

A brick and tile company leased land from Earl Loam at a minimum rent of £1,000 per annum and a royalty of 6d. per ton on all the clay raised, short workings to be recouped during the first four years. The clay raised in the first four years was as follows :—

1st year	28,200 tons.
2nd year	28,800 „
3rd year	33,400 „
4th year	55,800 „
5th year	60,000 „

Show the journal entries and ledger accounts relating to these transactions in the books of the company.

JOURNAL.

		Dr. £	*Cr.* £
1st year	Minimum Rent Account . . . . *Dr.*	1,000	
	To Landlord		1,000
	Being agreed minimum rent.		
„ „	Royalties Account . . . . . *Dr.*	705	
	To Minimum Rent		705
	Being royalties on output of 28,200 *tons at* 6*d. per ton.*		

JOURNAL—*continued.*

		Dr. £	Cr. £
1st year	Profit and Loss Account . . . . Dr. To Royalties Account . . . . . *Being balance transferred.*	705	705
" "	Short Workings Account . . . . Dr To Minimum Rent Account . . . . *Being balance transferred.*	295	295
2nd year	Minimum Rent Account . . . . Dr. To Landlord . . . . *Being agreed minimum rent.*	1,000	1,000
" "	Royalties Account . . . . . Dr. To Minimum Rent Account . . . . *Being royalties on output of* 28,800 *tons at* 6*d.*	720	720
" "	Profit and Loss Account . . . . Dr. To Royalties Account . . . . . *Being balance transferred.*	720	720
" "	Short Workings Account . . . . Dr. To Minimum Rent Account . . . . *Being balance transferred.*	280	280
3rd year	Minimum Rent Account . . . . Dr. To Landlord . . . . *Being agreed minimum rent.*	1,000	1,000
" "	Royalties Account . . . . . Dr. To Minimum Rent Account . . . . *Being royalties on output of* 33,400 *tons at* 6*d. per ton.*	835	835
" "	Profit and Loss Account . . . . Dr. To Royalties Account . . . . . *Being balance transferred.*	835	835
" "	Short Workings Account . . . . Dr. To Minimum Rent Account . . . . *Being balance transferred.*	165	165
4th year	Royalties Account . . . . . Dr. To Landlord . . . . *Being royalties on output of* 55,800 *tons at* 6*d. per ton.*	1,395	1,395
" "	Landlord . . . . Dr. To Short Workings Account . . . . *Being amount recoverable.*	395	395
" "	Profit and Loss Account . . . . Dr. To Royalties Account . . . . . *Being balance transferred.*	1,395	1,395

JOURNAL—*continued.*

		Dr. £	Cr. £
4th year	Profit and Loss Account . . . . *Dr.* To Short Workings Account . . . *Being amount irrecoverable under terms of lease, written off.*	345	345
5th year	Royalties Account . . . . . *Dr.* To Landlord . . . . *Being royalties on output of 60,000 tons at 6d. per ton.*	1,500	1,500

Dr. MINIMUM RENT ACCOUNT. *Cr.*

		£			£
1st year	To Landlord . .	1,000	1st year	By Royalties . .	705
				" Shortworkings .	295
		£1,000			£1,000
2nd "	To Landlord . .	1,000	2nd "	By Royalties . .	720
				" Shortworkings .	280
		£1,000			£1,000
3rd "	To Landlord . .	1,000	3rd "	By Royalties . .	835
				" Shortworkings .	165
		£1,000			£1,000

Dr. LANDLORD. *Cr.*

		£			£
1st year	To Cash	1,000	1st year	By Minimum Rent .	1,000
2nd "	" "	1,000	2nd "	" " .	1,000
3rd "	" "	1,000	3rd "	" " .	1,000
4th "	" "	1,000	4th "	" Royalties . .	1,395
" "	" Shortworkings .	395			
		£1,395			£1,395
5th "	" Cash . . .	1,500	5th "	" " .	1,500

Dr. ROYALTIES ACCOUNT. *Cr.*

		£			£
1st year	To Minimum Rent .	705	1st year	By Profit and Loss Account . .	705
2nd ,,	,, ,, .	720	2nd ,,	,, ,, ,,	720
3rd ,,	,, ,, .	835	3rd ,,	,, ,, ,,	835
4th ,,	,, Landlord . .	1,395	4th ,,	,, ,, ,,	1,395
5th ,,	,, ,, . .	1,500	5th ,,	,, ,, ,,	1,500

Dr. SHORT WORKINGS ACCOUNT. *Cr.*

		£			£
1st year	To Minimum Rent .	295	4th year	By Landlord . .	395
2nd ,,	,, ,, .	280	,, ,,	,, Profit and Loss Account . .	345
3rd ,,	,, ,, .	165			
		£740			£740

Dr. CASH BOOK. *Cr.*

					£
			1st year	By Landlord . .	1,000
			2nd ,,	,, ,, . .	1,000
			3rd ,,	,, ,, . .	1,000
			4th ,,	,, ,, . .	1,000
			5th ,,	,, ,, . .	1,500

Dr. PROFIT AND LOSS ACCOUNTS. *Cr.*

		£			
1st year	To Royalties . .	705			
2nd ,,	,, ,, . .	720			
3rd ,,	,, ,, . .	835			
4th ,,	,, ,, . .	1,395			
,, ,,	,, Shortworkings .	345			
5th ,,	,, Royalties . .	1,500			

HIRE-PURCHASE ACCOUNTS

Under the Hire-Purchase System, goods are delivered to a person (called the "hire-purchaser") in return for his undertaking to pay agreed amounts at specified intervals for a certain period, and on the understanding that at the end of that period, when the payments are completed, the goods become his absolute property. Hire-Purchase transactions are now controlled, to a large extent, by the Hire-Purchase Act, 1938, which came into operation on 1st January, 1939. The special features of these transactions are :—

(1) The goods remain the property of the vendor until the whole of the payments are completed, and if default is made he can take steps to recover them. By the Hire-Purchase Act, 1938, which applies only to hire-purchase agreements under which the total price does not exceed £50 in the case of motor vehicles, railway wagons or other railway stock, £500 in the case of livestock and £100 in the case of other articles) it is provided that where the hirer has paid one-third of the total price payable for the goods, the owner must not enforce any right to recover possession of the goods otherwise than by action in the County Court. Where, in such circumstances, the owner does apply to the Court, the Court may make any one of the following alternative orders :—

(a) It may order specific delivery of the goods to the owner ; or

(b) It may order specific delivery subject to postponement of the operation of the order on condition that the hirer or any guarantor pays the unpaid balance at such times and in such amounts and subject to the fulfilment of such other conditions as the Court thinks just ; or

(c) It may order some of the goods to become the property of the hirer and the remainder to be given up to the owner.

(2) Usually, the hire-purchaser is not *compelled* to complete the whole transaction ; and if he so desires, the agreement may be cancelled and the goods returned, but the hire-purchaser must forfeit the instalments he has paid. In cases where the Hire-Purchase Act applies it is provided that the hirer may determine the agreement by giving written notice of termination to the person entitled to receive the instalments, but in the event of such termination he is liable for all instalments then due plus the amount, if any, by which one-half of the

hire-purchase price exceeds the total of the sums paid and the sums due, or for such lesser amount as may be specified in the agreement.

(3) The hire-purchaser frequently has to undertake to keep the goods in sound repair and good condition until the last payment is made.

(4) In some cases, e.g., railway waggons, the sale price is the normal cash selling price, but the agreement provides that the purchaser shall pay interest at an agreed rate per annum on the balance outstanding.

(5) In other cases, principally for furniture and musical instruments, an agreed total sum is payable without any rate of interest being specified, but, nevertheless, the total price is composed of the cash price (the true selling value of the goods—which must be clearly shown when the agreement is completed in cases to which the Hire-Purchase Act applies), plus interest for the period during which payments are being made.

These transactions must be distinguished clearly from a purchase and sale by instalments, in which the absolute ownership is immediately transferred to the purchaser, and in which, on default by the purchaser, the vendor cannot reclaim the goods, but can sue for the unpaid instalments. The distinction is important, as under the hire-purchase system the goods do not become the property of the purchaser until the final payment has been made and, consequently, the vendor can recover the goods if the purchaser does not pay the instalments (subject, of course, to the provisions of the Hire-Purchase Act being complied with). Special treatment must be given to these transactions, both in the books of the vendor and in those of the purchaser.

The Books of the Vendor.

There are three methods which are usually adopted, according to the type and value of goods sold, and the length of the period of purchase.

METHOD I. In the case of a business which transacts numerous hire-purchase sales of a comparatively small value, it is preferable to open separate *memorandum* hire-purchase books. A Hire-Purchase Sales Day Book is kept, ruled to disclose both the Sale Price and the Cost Price of the goods. This book should also show the number of instalments payable and the number of the Hire-Purchase agreement. The Sale Price is debited to the

individual purchasers' accounts in a memorandum Hire-Purchase Ledger, these accounts being credited with all instalments paid. The total of the "sale price" column may be credited to an Adjustment Account, which will be debited with the total instalments received. If the agreement is cancelled by the hirer and the goods are returned any sum payable by virtue of the provisions of the Hire-Purchase Act (the amount, if any, by which one-half of the hire-purchase price exceeds the total of the sums paid and the sums due) should be credited when received to the individual purchaser's account in the Hire-Purchase Ledger and debited to the memorandum Adjustment Account. The amount then remaining unpaid on the cancelled agreement will be posted from a Hire-Purchase Returns Book (ruled similarly to the Hire-Purchase Sales Day Book) to the credit of the Hire-Purchaser's Account, and debited in total at the end of the period to the Adjustment Account.

If the hirer defaults and action is taken under the Hire-Purchase Act to recover the goods the entries necessary in the books will, of course, depend upon the order made by the Court :—

(1) If an order is made for specific delivery of the goods to the owner the instalments unpaid will be posted from the Hire-Purchase Returns Book to the credit of the Hire-Purchaser's Account, and debited in total at the end of the period to the Adjustment Account. This is the normal treatment of goods returned under Hire-Purchase Agreements.

(2) If an order is made for specific delivery subject to postponement of the operation of the order on condition that the hirer pays the unpaid balance at such times and in such amounts as the Court thinks just there are various methods of treating the reduced instalments payable by the hirer if he decides to continue the agreement. One method would be to bring down a balance on the Hire-Purchaser's Account at the date of change and to make a note of the alteration at the top of the account. The reduced instalments would then be posted to this account in the usual way. Another method would be to show the Hire-Purchaser's Account at the date of the order by a transfer of the balance to the Adjustment Account through the Hire-Purchase Returns Book, as though the goods were returned on that date, and then to open a new account for the balance in the same manner as an account would be opened for a new agreement.

(3) If an order is made for some of the goods to become the property of the hirer and the remainder to be given up to the owner the entries necessary in the memorandum Hire-Purchase records will be the same as in (1) above. The fact that only part of the goods are returned does not affect the records.

It must be emphasised that the above entries are of a *memorandum* nature only, and *do not form part of the ordinary double-entry system*, though the Hire-Purchase Ledger is made self-balancing, by means of the Adjustment Account.

In the *Financial Books* the personal aspect is ignored, the entries being recorded in total only.

The transactions are summarised in the General Ledger in the following manner :—

(1) The total stock issued to hirers each period is debited to a " Stock out on Hire-Purchase Account " at cost price (as disclosed by the Memorandum Hire-Purchase Sales Day Book), and credited to a Hire-Purchase Sales Account at the same figure, the latter account being closed at the end of the trading period by transfer to Trading Account.

(2) Stock returned by hirers upon cancellation of the agreements, or on default in accordance with the order of the Court, is debited to the Hire-Purchase Sales Account, and credited to the Stock out on Hire-Purchase Account. The amount is ascertained by computing the cost of the balances unpaid.

(3) The periodical total of instalments paid by hirers and any amounts paid on cancellation are credited to the Stock out on Hire-Purchase Account from the Cash Book.

(4) The goods returned will be brought into the general stock for Balance Sheet purposes, adequate allowance being made for depreciation caused through the use of the articles.

At the end of the financial year a schedule is prepared showing the amounts still to be paid by the hirers, from which is deducted the proportion of profit included in such amounts. The net total thus arrived at is credited to the Stock out on Hire-Purchase Account and brought down as the first debit entry in the same account for the next financial period. This account will then show a balance—usually a credit balance—representing the profit for the period, and this is transferred to the Profit and Loss Account.

EXAMPLE.

The following Hire-Purchase transactions were entered into by the Easy-Pay Furnishing Co., Ltd. :—

	Sale Price.	Cost.	Instalments.
1941.	£	£	
Jan. 1. J. Peel . . .	50	30	10 equal monthly.
„ 5. S. Healey . . .	20	14	5 „ „
„ 10. H. Sutcliffe. . .	72	48	12 „ „
„ 12. T. Wilson . . .	30	20	5 equal quarterly.
„ 20. A. Harrison . .	45	27	9 equal monthly.

All instalments were paid on the due dates except those of H. Sutcliffe, who failed to pay his instalments after April 1941. Action was taken under the Hire-Purchase Act to recover these goods and on 12th June the Court ordered specific delivery of these goods to the company.

Record the above transactions in the books of the company for the six months to 30th June 1941 (on the assumption that these were the only sales made during that period) and carry down the balances on that date.

MEMORANDUM HIRE-PURCHASE SALES DAY BOOK.

Date	Agreement Number.	Particulars.	Instalments.	H.P. Ledger Fol.	Total Price. £	s.	d.	Cost Price. £	s.	d.
1941.					£	s.	d.	£	s.	d.
Jan. 1	1	J. Peel . . .	10 equal monthly .	1	50	0	0	30	0	0
„ 5	2	S. Haley . . .	5 „ „ .	2	20	0	0	14	0	0
„ 10	3	H. Sutcliffe . .	12 „ „ .	3	72	0	0	48	0	0
„ 12	4	T. Wilson . .	5 equal quarterly.	4	30	0	0	20	0	0
„ 20	5	A Harrison. . .	9 equal monthly .	5	45	0	0	27	0	0
					£217	0	0	£139	0	0

MEMORANDUM HIRE-PURCHASE LEDGER.

Folio 1.

Dr. J. PEEL. *Cr.*

1941.			£	1941.			£
Jan. 1	To Goods . .		50	Jan. 1	By Cash . .		5
				Feb. 1	„ „ . .		5
				Mar. 1	„ „ . .		5
				Apl. 1	„ „ . .		5
				May 1	„ „ . .		5
				June 1	„ „ . .		5
				„ 30	„ Balance . .	*c/d.*	20
			£50				£50
July 1	To Balance . .	*b/d.*	20				

Folio. 2

Dr. S. HALEY. *Cr.*

1941.			£	1941.			£
Jan. 5	To Goods . .		20	Jan. 5	By Cash . .		4
				Feb. 5	„ „ . .		4
				Mar. 5	„ „ . .		4
				Apl. 5	„ „ . .		4
				May 5	„ „ . .		4
			£20				£20

Folio 3.

Dr. H. SUTCLIFFE. *Cr.*

1941.			£	1941.			£
Jan. 10	To Goods . .		72	Jan. 10	By Cash . .		6
				Feb. 10	„ „ . .		6
				Mar. 10	„ „ . .		6
				Apl. 10	„ „ . .		6
				June 12	„ Returns . .		48
			£72				£72

Folio 4.

Dr. T. WILSON. *Cr.*

1941.			£	1941.			£
Jan. 12	To Goods . .		30	Jan. 12	By Cash . .		6
				Apl. 12	„ „ . .		6
				June 30	„ Balance . .	*c/d.*	18
			£30				£30
July 1	To Balance . .	*b/d.*	18				

Folio 5.

Dr. A. HARRISON. *Cr.*

1941.			£	1941.			£
Jan. 20	To Goods . .		45	Jan. 20	By Cash . .		5
				Feb. 20	„ „ . .		5
				Mar. 20	„ „ . .		5
				Apl. 20	„ „ . .		5
				May 20	„ „ . .		5
				June 20	„ „ . .		5
				„ 30	„ Balance . .	*c/d.*	15
			£45				£45
July 1	To Balance . .	*b/d.*	15				

ADJUSTMENT ACCOUNT.

Dr.				Cr.			
1941.			£	1941.			£
June 30	To Cash		116	June 30	By Goods		217
	„ Returns		48				
	„ Balance	c/d.	53				
			£217				£217
				July 1	By Balance	b/d.	53

[EXTRACTS FROM] CASH BOOK.

Dr.		H.P. Ledger.	£			Cr.
1941.						
Jan. 1	To J. Peel	1	5			
„ 5	„ S. Haley	2	4			
„ 10	„ H. Sutcliffe	3	6			
„ 12	„ T. Wilson	4	6			
„ 20	„ A. Harrison	5	5			
Feb. 1	„ J. Peel	1	5			
„ 5	„ S. Haley	2	4			
„ 10	„ H. Sutcliffe	3	6			
„ 20	„ A. Harrison	5	5			
Mar. 1	„ J. Peel	1	5			
„ 5	„ S. Haley	2	4			
„ 10	„ H. Sutcliffe	3	6			
„ 20	„ A. Harrison	5	5			
Apl. 1	„ J. Peel	1	5			
„ 5	„ S. Haley	2	4			
„ 10	„ H. Sutcliffe	3	6			
„ 12	„ T. Wilson	4	6			
„ 20	„ A. Harrison	5	5			
May 1	„ J. Peel	1	5			
„ 5	„ S. Haley	2	4			
„ 20	„ A. Harrison	5	5			
June 1	„ J. Peel	1	5			
„ 20	„ A. Harrison	5	5			
			£116			

[In practice the Cash Book would probably be of the columnar type, with a column for Hire-Purchase Instalments, in which the above entries would appear.]

GENERAL LEDGER.

STOCK OUT ON HIRE-PURCHASE ACCOUNT.

Dr.				Cr.			
1941.			£	1941.			£
June 30	To Cost of Stock sent out on Hire-Purchase, *per* Day Book		139	June 30	By Cash		116
				„ 30	„ Hire-Purchase Sales Account-Returns		32
„ 30	„ Profit and Loss Account		42	„ 30	„ Stock out on Hire-Purchase, *per* Schedule	c/d.	33
			£181				£181
July 1	To Balance	b/d.	33				

Dr. HIRE-PURCHASE SALES ACCOUNT. Cr.

		£			£
1941.			1941.		
June 30	To Stock out on Hire-Purchase Account —Goods Returned.	32	June 30	By Stock out on Hire-Purchase Account.	139
„ 30	„ Trading Account *	107			
		£139			£139

* Alternatively, this figure may be credited to Purchases Account, the net balance on which would be transferred to Trading Account.

The valuation of the cost of H. Sutcliffe's goods returned is computed: Ratio of Unpaid Instalments to Total Instalments is 8:12. Cost of unpaid instalments $= \frac{8}{12}$ of £48 = £32.

VALUATION OF HIRE-PURCHASE STOCK ON 30TH JUNE, 1941.

H.P. Ledger.	Total Instalments.	Instalments Paid.	Instalments Unpaid.	Total Cost.	Proportion of Cost Unpaid.	Value of Stock.
				£ s. d.		£ s. d.
1	10	6	4	30 0 0	4/10	12 0 0
4	5	2	3	20 0 0	3/5	12 0 0
5	9	6	3	27 0 0	3/9	9 0 0
					Total Stock.	£33 0 0

METHOD II. Where the goods are of considerable value, but the transactions are not numerous (the type of concern that will not be affected by the provisions of the Hire-Purchase Act), the vendor may debit the hire-purchaser with the cash price of the goods, and, as each instalment falls due, debit him also with interest on the amount owing, the balance being brought down periodically in the usual manner. Under this method, the ordinary selling price is credited to Sales Account, or to a special Hire-Purchase Sales Account, and is subsequently transferred to Trading Account as part of the total sales for the year in which the sale is effected. Similarly, Interest Account is credited with its proportion of interest as the instalments fall due, and thus it is arranged that the accounts for each year correctly include all transactions falling within that period.

If the goods are returned and the agreement cancelled, the amount unpaid is credited to the purchaser and debited to Sales Returns Account. The hire-purchaser, however, must pay interest from the date of the last instalment to the date on which the goods are returned, and, if the goods are not in sound condition, he may also have to pay for the cost of reconditioning them, according to the terms of the contract.

EXAMPLE.

The Waxwell Waggon Co., Ltd., disposes of 4 waggons to the Ewell Colliery Co., Ltd., on the hire-purchase system. The agreed cash selling price is £850, which is to bear interest at 6% per annum with half-yearly rests. A payment of £200 is to be made on delivery and the balance by half-yearly instalments of £120 at the end of June and December, the final instalment being adjusted to the exact amount due. Show the ledger accounts in the vendor's books.

Dr. THE EWELL COLLIERY CO., LTD. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 1	To Sales (Waggons)		850 0 0	Jan. 1	By Cash . .		200 0 0
June 30	„ Six Months' Interest at 6% p.a. on £650 .		19 10 0	June 30	„ „ . .		120 0 0
				„ „	„ Balance . .	c/d.	549 10 0
			£869 10 0				£869 10 0
June 30	To Balance . .	b/d.	549 10 0	Dec. 31	By Cash . .		120 0 0
Dec. 31	„ Interest on £549 10s .		16 9 9	„ „	„ Balance . .	c/d.	445 19 9
			£565 19 9				£565 19 9
				19..			
Dec. 31	To Balance . .	b/d.	445 19 9	June 30	By Cash . .		120 0 0
19..				„ „	„ Balance . .	c/d.	339 7 4
June 30	„ Interest on £445 19s 9d .		13 7 7				
			£459 7 4				£459 7 4
June 30	To Balance . .	b/d.	339 7 4	Dec. 31	By Cash . .		120 0 0
Dec. 31	„ Interest on £339 7s 4d .		10 3 7	„ „	„ Balance . .	c/d.	229 10 11
			£349 10 11				£349 10 11
				19..			
Dec. 31	To Balance . .	b/d.	229 10 11	June 30	By Cash . .		120 0 0
19..				„ „	„ Balance . .	c/d.	116 8 8
June 30	„ Interest on £229 10s 11d .		6 17 9				
			£236 8 8				£236 8 8
June 30	To Balance . .	b/d.	116 8 8	Dec. 31	By Cash . .		119 18 6
Dec. 31	„ Interest on £116 8s 8d .		3 9 10				
			£119 18 6				£119 18 6

Dr. SALES ACCOUNT. *Cr.*

				£ s. d.
This account will be closed by transfer to the Trading Account for the year in which the sale took place.	19.. Jan. 1	By Ewell Colliery Co.		850 0 0

Dr. INTEREST ACCOUNT. *Cr.*

	Date	Particulars	£	s.	d.
This account will be closed each year by transfer to the Profit and Loss Account.	19..				
	June 30	By Ewell Colliery Co.	19	10	0
	Dec. 31	,, ,, ,,	16	9	9
			£35	19	9
	19..				
	June 30	By Ewell Colliery Co.	13	7	7
	Dec. 31	,, ,, ,,	10	3	7
			£23	11	2
	19..				
	June 30	By Ewell Colliery Co.	6	17	9
	Dec. 31	,, ,, ,,	3	9	10
			£10	7	7

METHOD III. An alternative to Method II. is sometimes adopted, whereby the cash selling price is credited to revenue for the period in which the sale takes place, while the interest included in the hire-selling price is transferred to an Interest Suspense Account, which is transferred to Profit and Loss Account over the period elapsing between the date of the sale and the date when the final instalment is paid by the purchaser. As compared with Method II., interest is transferred to Profit and Loss Account in total in respect of the sales for the period, instead of being computed separately in respect of each hire-purchase debtor.

Apportionment of the sale price of each transaction between Sales Account (which is credited with the cash selling price) and Interest Suspense Account is best effected by the use of a columnar Hire-Purchase Sales Journal ruled as follows :—

Date.	Name and Particulars.	Fo.	Details.			Invoice Total.			Cash Selling Price.			Interest Suspense.		
			£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

The individual amounts in the " Invoice Total " column are debited to the hire-purchaser, whilst the totals for the month of the " Cash Selling Price " and the " Interest Suspense " columns

are credited to Hire-Purchase Sales Account and Interest Suspense Account respectively. The sales for the year are credited in due course to the Trading Account, whilst that portion of the Interest Suspense Account which represents the current year's interest is transferred to the credit of Profit and Loss Account. The balance of the Interest Suspense Account is carried forward as a reserve and appears in the Balance Sheet as a liability.

EXAMPLE.

Assuming the same facts as in the Example on page 548, with an agreed cash selling price of £850 and a total addition for interest of £69 18s. 6d., show the ledger accounts at the end of the first year in the vendor's books.

Dr. THE EWELL COLLIERY CO., LTD. *Cr.*

			£ s. d.				£ s. d.
19.. Jan. 1	To Sale (Waggons)		850 0 0	19.. Jan. 1	By Cash . .		200 0 0
	„ Interest Suspense Account		69 18 6	June 30	„ „ . .		120 0 0
					„ Balance . .	*c/d.*	599 18 6
			£919 18 6				£919 18 6
July 1	To Balance . .	*b/d.*	599 18 6	Dec. 31	By Cash . .		120 0 0
					„ Balance .	*c/d.*	479 18 6
			£599 18 6				£599 18 6
19.. Jan. 1	To Balance . .	*b/d.*	479 18 6				

Dr. HIRE-PURCHASE SALES ACCOUNT. *Cr.*

							£ s. d.
	The account will be closed by transfer to the Trading Account for the year in which the sale took place.			19.. Jan. 1	By Ewell Colliery Co. Ltd. . .		850 0 0

Dr. INTEREST SUSPENSE ACCOUNT. *Cr.*

							£ s. d.
	Interest will be transferred to the credit of Profit and Loss Account in total in respect of the interest relating to the year.			19.. Jan. 1	By Ewell Colliery Co., Ltd. .		69 18 6

NOTE.—The transfer for interest in respect of the above transaction will amount to £35 19s. 9d. for the first year (see page 549).

If a trader using Methods II. or III. does deal in goods coming within the provisions of the Hire-Purchase Act he will have to make the necessary adjustments to record properly the cancellation by the hirer in accordance with the provisions of the Act and in the case of default any alterations of instalments ordered by the Court.

The Hire-Purchaser's Books.

The following are the principal methods of recording hire-purchase transactions in the purchaser's books :—

METHOD I. The full cash price is debited to the Asset Account and the same figure credited to the Vendor's Account. Interest is then credited periodically to the latter account, all cash payments being debited thereto The transaction is shown in the hire-purchaser's Balance Sheet by deducting the outstanding credit balance on the Vendor's Account from the depreciated book value of the asset.

The transactions outlined on page 548 would be recorded in the following manner, assuming that the purchaser charges depreciation at 10% per annum on the reducing instalment system.

Dr. WAGGON ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19.. Jan. 1	To Waxwell Waggon Co., Ltd.		850 0 0	19.. Dec. 31	By Depreciation		85 0 0
					,, Balance	c/d.	765 0 0
			£850 0 0				£850 0 0
19.. Jan. 1	To Balance	b/d.	765 0 0	19.. Dec. 31	By Depreciation		76 10 0
					,, Balance	c/d.	688 10 0
			£765 0 0				£765 0 0
19.. Jan. 1	To Balance	b/d.	688 10 0	19.. Dec. 31	By Depreciation		68 17 0
					,, Balance	c/d.	619 13 0
			£688 10 0				£688 10 0
19.. Jan. 1	To Balance	b/d.	619 13 0				

Dr. WAXWELL WAGGON CO., LTD. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 1	To Cash		200 0 0	Jan. 1	By Waggon Account		850 0 0
June 30	" "		120 0 0	June 30	" Interest		19 10 0
	" Balance	c/d.	549 10 0				
			£869 10 0				£869 10 0
Dec. 31	To Cash		120 0 0	July 1	By Balance	b/d.	549 10 0
	" Balance	c/d.	445 19 9	Dec. 31	" Interest		16 9 9
			£565 19 9				£565 19 9
19..				19..			
June 30	To Cash		120 0 0	Jan. 1	By Balance	b/d.	445 19 9
	" Balance	c/d.	339 7 4	June 30	" Interest		13 7 7
			£459 7 4				£459 7 4
Dec. 31	To Cash		120 0 0	July 1	By Balance	b/d.	339 7 4
	" Balance	c/d.	229 10 11	Dec. 31	" Interest		10 3 7
			£349 10 11				£349 10 11
19..				19..			
June 30	To Cash		120 0 0	Jan. 1	By Balance	b/d.	229 10 11
	" Balance	c/d.	116 8 8	June 30	" Interest		6 17 9
			£236 8 8				£236 8 8
Dec. 31	To Cash		119 18 6	July 1	By Balance	b/d.	116 8 8
				Dec. 31	" Interest		3 9 10
			£119 18 6				£119 18 6

Dr. INTEREST ACCOUNT. *Cr.*

			£ s. d.	
19..				
June 30	To Waxwell Co.		19 10 0	This account is closed each year by a transfer to the debit of Profit and Loss Account.
Dec. 31	" "		16 9 9	
			£35 19 9	
19..				
June 30	To Waxwell Co.		13 7 7	
Dec. 31	" "		10 3 7	
			£23 11 2	
19..				
June 30	To Waxwell Co.		6 17 9	
Dec. 31	" "		3 9 10	
			£10 7 7	

Dr. DEPRECIATION ACCOUNT. Cr.

		£ s. d.	
19.. Dec. 31	To Waggon A/c. . .	85 0 0	This account is closed each year by a transfer to the debit of Profit and Loss Account.
19.. Dec. 31	To Waggon A/c. . .	76 10 0	
19.. Dec. 31	To Waggon A/c. . .	68 17 0	

The advantage of this method is that the full value of the asset and the liability to the vendor at any time are disclosed by the books.

METHOD II. As the goods do not become the property of the hirer until the purchase is fully completed, it is sometimes considered that no entry should be made in his books until each instalment becomes due, except in cases where a payment is made on delivery of the goods, when this payment is debited wholly to the asset account. Each subsequent payment is divided into two portions, one portion representing part of the purchase price and the balance being the interest, as indicated in the following journal entry :—

			£ s. d.	£ s. d.
19.. June 30	Sundries . . . . . *Dr.*			
	To Waxwell Waggon Co., Ltd. .			120 0 0
	Waggon Account. . . .		100 10 0	
	Interest Account . . .		19 10 0	
	Being apportionment of payment made this date for hire purchase of waggons.			

The asset account is thus debited with the actual amount paid as part of the purchase price, and Interest Account is debited with the amount of interest paid.

Any expenditure on repairs is debited to Profit and Loss in the year in which the repairs are effected, and further, depreciation must be charged on the FULL CASH VALUE of the waggons, so that by the time the last payment is made, the book value of the asset appears at its true value on that date, i.e., its original value less depreciation.

EXAMPLE.

Show the ledger accounts in the books of the Ewell Colliery Co., Ltd., for the hire-purchase transactions outlined on page 548, providing for depreciation at 10% per annum on the reducing instalment system.

Dr. THE WAXWELL WAGGON CO., LTD. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 1	To Cash . .		200 0 0	Jan. 1	By Waggon A/c. .		200 0 0
June 30	" " . .		120 0 0	June 30	" " A/c. .		100 10 0
					" Interest A/c. .		19 10 0
			£320 0 0				£320 0 0
Dec. 31	To Cash . .		120 0 0	Dec. 31	By Waggon A/c. .		103 10 3
					" Interest A/c. .		16 9 9
			£120 0 0				£120 0 0
19..				19..			
June 30	To Cash . .		120 0 0	June 30	By Waggon A/c. .		106 12 5
					" Interest A/c. .		13 7 7
			£120 0 0				£120 0 0
Dec. 31	To Cash . .		120 0 0	Dec. 31	By Waggon A/c. .		109 16 5
					" Interest A/c. .		10 3 7
			£120 0 0				£120 0 0
19..				19..			
June 30	To Cash . .		120 0 0	June 30	By Waggon A/c. .		113 2 3
					" Interest A/c. .		6 17 9
			£120 0 0				£120 0 0
Dec. 31	To Cash . .		119 18 6	Dec. 31	By Waggon A/c. .		116 8 8
					" Interest A/c. .		3 9 10
			£119 18 6				£119 18 6

Dr. WAGGON ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
19..				19..			
Jan. 1	To Waxwell Co. .		200 0 0	Dec. 31	By Depn., 10% on £850 . .		85 0 0
June 30	" " .		100 10 0				
Dec. 31	" " .		103 10 3	" 31	" Balance . .	c/d.	319 0 3
			£404 0 3				£404 0 3
				19..			
Dec. 31	To Balance . .	b/d.	319 0 3	Dec. 31	By Depn., 10% on £765 . .		76 10 0
19..							
June 30	" Waxwell Co. .		106 12 5	" "	" Balance . .	c/d.	458 19 1
Dec. 31	" " .		109 16 5				
			£535 9 1				£535 9 1
				19..			
Dec. 31	To Balance . .	b/d.	458 19 1	Dec. 31	By Depn., 10% on £688 10s. .		68 17 0
19..							
June 30	" Waxwell Co. .		113 2 3	" "	" Balance . .	c/d.	619 13 0
Dec. 31	" " .		116 8 8				
			£688 10 0				£688 10 0
19..							
Dec. 31	To Balance . .	b/d.	619 13 0				

The accounts for Interest and Depreciation will be similar to those in the previous example, shown on pages 552 and 553 respectively.

METHOD III. In the furniture and musical instrument trade, the hire-purchasers are mostly retail buyers who rarely keep account books, and their view-point does not call for consideration. As, however, many small manufacturers purchase their plant and machinery, etc., in this way, it is necessary to outline the entries required to record the transactions.

These entries may be made in the same manner as either Methods I. or II. above, but under either of these methods it is necessary for the purchaser to know the cash selling price of the asset purchased.

An alternative method is for the hire-purchaser to estimate what the asset will be worth (after allowing for wear and tear or depreciation) when the instalments are finally completed, and to treat the difference between that value and the total amount paid as "COST OF HIRE." Each instalment is then apportioned on that basis between the asset account and the Cost of Hire Account.

EXAMPLE.

Assets are purchased for £750, payable by quarterly instalments of £62 10s. for three years, and it is estimated that at the end of this period the assets will be worth £540. Apportion each instalment between the Asset Account and Cost of Hire Account on this basis, and show the ledger accounts.

Dr. VENDOR'S ACCOUNT. *Cr.*

		£			£
During 1st year	To Cash	250	During 1st year	By Asset Account .	180
			,,	,, Cost of Hire Account . .	70
		£250			£250
During 2nd year	To Cash	250	During 2nd year	By Asset Account .	180
			,,	,, Cost of Hire Account . .	70
		£250			£250
During 3rd year	To Cash	250	During 3rd year	By Asset Account .	180
			,,	,, Cost of Hire Account . .	70
		£250			£250

Dr. ASSET ACCOUNT. *Cr.*

			£				£
1st year	To Vendor . .		180	2nd year	By Balance .	*c/d.*	360
2nd year	„ „ . .		180				
			£360				£360
2nd year	To Balance . .	*b/d.*	360	3rd year	By Balance .	*c/d.*	540
3rd year	„ Vendor . .		180				
			£540				£540
3rd year	To Balance . .	*b/d.*	540				

Dr. COST OF HIRE ACCOUNT. *Cr.*

			£	
1st year	To Vendor . .		70	This account is closed each year by a transfer to the debit of Profit and Loss Account.
2nd year	„ Vendor . .		70	
3rd year	„ Vendor . .		70	

The advantage of the method here illustrated lies in its simplicity and the fact that the charge to Profit and Loss Account is equalised over the whole period. It is, however, a somewhat arbitrary method and should only be employed when the amounts involved are comparatively small.

The effect of the Hire-Purchase Act on the entries in the hirer's books has not been explained, because the Act mainly affects such transactions as the purchase of furniture, wireless sets, second-hand cars, etc., on hire-purchase terms by private individuals who would not usually keep any records of the transaction.

PURCHASE AND SALE BY INSTALMENTS

Where goods are sold outright but are to be paid for by instalments, the legal position is that the property in the goods is immediately transferred to the purchaser, and if the purchaser defaults, the seller cannot claim possession of the goods. His remedy is by action at law for the money owing in the ordinary manner.

The sale price, however, includes interest, and the seller must therefore apportion the sale price between Sales Account and Interest Suspense Account in the manner outlined in the preceding pages, transferring each year to Profit and Loss Account the proportionate amount of interest that has been earned. An adequate reserve must be made for possible bad debts resulting from non-payment of future instalments.

On delivery the purchaser must credit the vendor with the

full amount that he has agreed to pay. The debit entries must be apportioned between the Asset Account and Interest Suspense Account, a proportionate part of the latter account being debited each year to Profit and Loss Account.

With all transactions involving hire-purchase and purchase by instalments it is a convenient practice for the purchaser's account to contain—as a sub-heading—a concise summary of the terms of sale.

MAINTENANCE AND REPAIRS AGREEMENTS

Agreements for the sale of certain articles, such as sewing-machines and typewriters, frequently contain a clause under which the vendor agrees to maintain the article in a good state of repair for a specified number of years. In such cases credit should not be taken immediately for the entire sale price of the goods. A percentage of the sale price, based on past experience, should be debited to Sales Account and credited to a Maintenance and Repairs Reserve to cover the estimated liability under the guarantee. A separate reserve should be opened in respect of each year and the sum charged apportioned over the several years on the basis of the estimated incidence of the actual expenses for maintenance and repairs over the period of guarantee. When actual expenditure on maintenance or repairs is incurred under the guarantee this should be charged to the appropriate reserve, the surplus on which should be transferred to Profit and Loss Account at the end of the year. If in any year the expenses incurred are greater than the reserve made then the deficiency should be charged to Profit and Loss Account and, if necessary, the percentage in respect of future transactions should be adjusted.

In order to avoid a multitude of independent calculations, it is usual to transfer a percentage of the *total* sales to the Maintenance Reserve each year. Thus, if sales are assumed to be distributed evenly throughout the year to 31st December, the transfer to the Maintenance Reserve for the year might be made on the assumption that all sales were effected on 30th June, and that, on an average, six months of the guarantee on the year's sales had expired at 31st December. In this way, if the guarantee is for two years, the reserve for each year's sales will affect *three* year's accounts.

VOYAGE ACCOUNTS

It is customary for shipping companies to keep separate voyage accounts for each vessel in order to ascertain the profit or loss which results from each voyage. In form a voyage account is similar to an ordinary profit and loss account. All expenses relating to the voyage, including stores, wages, insur-

ance, commission, brokerage, etc., are debited to this account, whilst all earnings, passage money, freight, and mail money (if any) are credited. The value of stores on hand at the end of the voyage is credited to this account, and is debited to the succeeding voyage account of the same vessel. The balance of the account represents the profit or loss on the voyage, and is transferred to the general Profit and Loss Account. An example is appended.

It should be noted that, under the Merchant Shipping Acts, the property in a British ship is divided into sixty-fourths, and not more than sixty-four shares can be registered. Two or more persons, however, may combine to hold one share jointly. The word "share" denotes the owner's interest in the vessel, and must not be confused with the word "share" as applied in the case of a limited company.

VOYAGE ACCOUNT OF ss. "ALBANIA."

Dr. VOYAGE No. 21. 1ST JANUARY TO 28TH FEBRUARY, 19.. *Cr.*

	£		£
To Stores Consumed . .	1,770	By Freight	9,520
„ Port Charges . . .	1,014	„ Passage Money . .	1,260
„ Stevedoring and Labour .	506		
„ Bunker Coals . . .	2,796		
„ Wages	1,240		
„ Insurance on Hull, 2 months	600		
„ Insurance on Freight .	120		
„ Brokerage on Freight, 2½ per cent. . . .	238		
„ Commission on Passage Money, 5 per cent. .	63		
„ Balance—Net Profit . .	2,433		
	£10,780		£10,780

STEAMSHIP COMPANIES INSURANCE FUNDS.

The risk of loss arising out of the perils of the sea is one which is usually provided against by contracts of Marine Insurance, entered into with insurance companies or underwriters. When, however, a steamship company owns numerous vessels it frequently adopts the policy of covering the whole or a part of the risk by instituting an Internal Insurance Fund.

In such cases, the method employed is to charge each Voyage Account, and to credit an Insurance Fund Account with an amount equal to, or greater than, the premium which would have to be paid if the risk were covered by professional insurers.

Corresponding amounts are invested in gilt-edged securities, cash being credited and an Insurance Fund Investment Account debited.

The income from the investments is credited to the Insurance Fund Account, which is debited with the expenses of administering the fund and with losses sustained.

During the earlier years of an Insurance Fund, it is necessary to avoid the possibility of considerable losses falling upon a comparatively small fund by confining the company's risk to one portion only of each vessel, or, as it is technically called, by "taking a line" upon each ship.

As the fund grows, the proportion of each ship internally insured can safely be increased until, eventually, the Insurance Fund bears the whole risk, and the services of outside insurers are entirely dispensed with.

INVESTMENT ACCOUNTS

These accounts record particulars of money invested in any of the various types of securities. A separate ledger account should be opened for each investment, and it is desirable that it should be in columnar form so as to show clearly—

(1) The nominal amount of the stock, shares, or other security ;

(2) The income received, i.e., dividends or interest ; and

(3) The actual cash paid representing the capital invested.

When the securities are purchased, the investment account is debited with the total cost, but as it sometimes happens that the securities are purchased "cum div.," i.e., including the accrued portion of the pending dividend or interest, the purchase price must be apportioned between capital and revenue.

For example, £2,000 3½ per cent. War Loan, on which interest is payable on 1st June and 1st December, is purchased on 1st April at 102 cum. div. Brokerage and stamps amount to £3 5s., so the total cost is £2,043 5s. A full half-year's interest (£35) is received on 1st June, but only two months' interest can be correctly appropriated as revenue. Therefore, to adjust the transaction between capital and revenue, it is assumed that four-sixths of the six months' interest, i.e., £23 6s. 8d., is included in the purchase price, £2,043 5s., and accordingly £2,019 18s. 4d. is placed to the debit of capital and £23 6s. 8d. to the debit of revenue. The whole dividend when received will be credited to the income column, and the Investment Account will thus include two months' interest only as the net income for the half-year.

Interest payable { 1st June. / 1st December.

Dr. 3½% WAR LOAN **Cr.**

Date.	Particulars.	Fo.	Nominal Amount.	Income.	Capital.	Date.	Particulars.	Fo.	Nominal Amount.	Income.	Capital.
			£ s. d.	£ s. d.	£ s. d.				£ s. d.	£ s. d.	£ s. d.
19.. April 1	To Cash—					19.. June 1	By Cash—			35 0 0	
	£2000 at 102 £2,040 0 0 Brkge. & Stps. 3 5 0		2000 0 0	23 6 8	2,019 18 4	Sept. 30	,, Cash— £1000 at 102½ £1,025 0 0 *Less* Bkge., etc. 1 15 0 £1,023 5 0		1,000 0 0	11 13 4	1,011 11 8
Dec. 31	,, Investment Div. and Int. Account . .			43 15 0							
						Dec. 1	,, Cash			17 10 0	
						,, 31	,, Interest accrued . .	c/d.		2 18 4	
						,, ,,	,, Balances . . .	c/d.	1,000 0 0		1,008 6 8
			£2,000 0 0	£67 1 8	£2,019 18 4				£2,000 0 0	£67 1 8	£2,019 18 4
19.. Jan. 1	To Balances	b/d.	1000 0 0	2 18 4	1,008 6 8						

NOTES : (1) Where part of the investment is sold at a profit, it is not usual to transfer the profit on the portion sold to the credit of Profit and Loss Account, but to wait until the whole of the investment is finally disposed of. Any loss on sale must, however, be written off.

(2) If the interest had been of a fluctuating nature, the full purchase price of £2,043 5s. 0d. would have been debited to capital at the time of purchase, and the interest of £35 received on 1st June credited $\frac{2}{3}$ths (£23 6s. 8d.) to capital, and $\frac{1}{3}$th (£11 13s. 4d.) to income. (See also page 561).

Brokerage and stamps are a charge against capital and must be debited to capital account as part of the purchase price. In similar manner, the brokerage incurred on a sale of the investment is treated as a capital charge and is deducted from the sale price, only the net proceeds being credited to the capital column of the Investment Account.

Where investments are sold cum. div. the income accrued to the date of sale will be credited to income column and the balance treated as capital, and the difference between the two capital columns will be the profit or loss on the sale.

The above method can only be used when the interest is fixed (e.g., as in the case of $3\frac{1}{2}\%$ War Loan, illustrated in the example on page 560), but in cases when the amount of dividend is not known, the full purchase or sale price will be debited or credited to capital, the dividend being adjusted between income and capital when received.

When investments are purchased or sold "ex. div." the price paid or received will have deducted from it the *full* impending dividend, and this dividend, when paid, will go to the seller of the investments. Consequently, a purchaser of investments ex. div. will not receive the next dividend paid, but he is compensated for this loss by paying a price lower, by the amount of the dividend, than he would otherwise have paid. It is necessary, however, to credit income and debit capital with the amount of dividend applicable to the period between the date of purchase and the date of the dividend. On a sale "ex. div." the vendor receives a dividend which partly covers a period subsequent to the date of sale. The proportion of this dividend applicable to the period between the date of sale and the date of the dividend should therefore be regarded as capital and credited to the capital column, in augmentation of the proceeds of sale.

EXAMPLE.

£2,000, $3\frac{1}{2}\%$ War Loan is purchased ex. div. on 1st May, 1940, at $100\frac{1}{2}$. On 1st May, 1941, £1000 of the stock is sold at 100 ex. div. Write up the Investment Account for the period to 30th June 1941, and carry down the balances on that date. Ignore brokerage and expenses.

Dr. 3½% WAR LOAN. *Cr.*

Date.	Particulars.	Fo.	Nominal.	Income.	Capital.	Date.	Particulars.	Fo.	Nominal.	Income.	Capital.
1940			£ s. d.	£ s. d.	£ s. d.	1940			£ s. d.	£ s. d.	£ s. d.
May 1	To Cash-Purchase of £2,000 @ 100½ ex. div. . .		2,000 0 0		2,010 0 0	June 1	By Transfer from Capital—Income accrued to date .			5 16 8	
June 1	,, Transfer to Income				5 16 8	Dec. 1	,, Cash—Dividend .			35 0 0	
1941 June 30	,, Income Account .			75 16 8		1941 May 1	,, Cash — Sale of £1,000 @ 100 ex. div. . . .		1,000 0 0		1,000 0 0
						June 1	,, Cash—Dividend .			32 1 8	2 18 4
						,, 1	,, Profit and Loss Account—Loss on Sale . . .				5 0 0
						,, 30	,, Interest accrued .	c/d.		2 18 4	
						,, 30	,, Balances . .	c/d.	1,000 0 0		1,007 18 4
			£2,000 0 0	75 16 8	2,015 16 8				£2,000 0 0	75 16 8	2,015 16 8
July 1	To Balances . .	b/d.	1,000 0 0	2 18 4	1,007 18 4						

NOTES: (1) One month's dividend accrued is debited to capital on 1st June, 1940, and credited to income, in respect of the period from 1st May to 1st June, 1940.

(2) On 1st June, 1941, one month's dividend in respect of the £1,000 stock sold must be credited to capital, since the *full* dividend has been deducted in arriving at the "ex. div." price.

(3) The loss on sale must be written off. This is computed:—

Cost of £1,000 stock = ½ of £2,015 16s. 8d.	=	£1,007 18 4
Amount received on sale . .		1,002 18 4
Loss on Sale		£ 5 0 0

(4) The stock unsold is carried down at cost.

At the end of the financial period interest accrued and not received should be credited to the income column of the Investment Account, and brought down as a debit entry for the next period. The balance of the income columns is transferred to the credit of Investment Dividends and Interest Account and subsequently to the credit of the general Profit and Loss Account.

With some concerns, however, the practice is to ignore all outstanding dividends and interest receivable, credit being taken only for the dividends and interest actually received. In such cases, the accrued dividends and interest form a secret reserve. In any event, where there is any doubt as to when the next payment of interest or dividend will be received, the amount accrued should be ignored, otherwise profits may be over-estimated.

Any increase in the market price of the securities should be ignored, but an Investment Depreciation Reserve Account should be raised to cover any decrease. Where the depreciation appears to be permanent the Investment Account should be written down, but ordinary market fluctuations need not be taken into account. It is desirable, however, to add a footnote to the Balance Sheet stating the present market value.

STOCKBROKERS' ACCOUNTS

The operations on the Stock Exchange are carried on by its members, who are either jobbers who actually buy and sell investments, or brokers who merely act as intermediaries between the jobbers and the public. The price quoted by a jobber to a broker is usually a double price, the lower figure being the jobber's buying price and the higher his selling price. The investor, except in the case of certain classes of stocks, pays for his purchases and receives cash in respect of his sales at the end of the "account." Where a purchaser of shares is allowed to carry over shares, i.e., defer acceptance and payment from one account to another, he is charged interest (i.e., contango) on the value of the shares carried over.

The following example illustrates the records in a stock-broker's ledger where a client has effected a number of transactions over a period :—

EXAMPLE.

Thomas Wilson had the following transactions with his broker. Show Wilson's account in the broker's ledger.

10th January : purchase of 100 Midland Bank shares (£2 10s. 0d. paid) at Commission £8, and Contract stamp £5 2s. 0d. 17th March : purchase of £500 India 3% stock at 63, Commission $\frac{1}{4}$%, Contract stamp 6s. 0d. 18th June : purchase of £800 Victoria 4% Inscribed stock at 101, Commission $\frac{1}{4}$%, Contract stamp 2s. 0d.

3rd June : sale of the 100 Midland Bank shares (£2 10s. 0d. paid) at £8 2s. 6d., Commission, etc., £5 10s. 0d., and sale of the £500 India 3% stock at 61, Commission $\frac{1}{4}$%. The Victoria stock was carried forward at par, contango being charged at $\frac{1}{4}$%.

Dr. THOMAS WILSON. **Cr.**

19..			£	s.	d.	19..			£	s.	d.
Jan. 10	To 100 Midland Bank shares (£2 10s. paid) @ £8		800	0	0	June 3	By 100 Midland Bank shares (£2 10s. paid) at £8 2s. 6d.		812	10	0
	,, Commission and Contract stamp		5	2	0		,, £500 India 3% stock @ 61		305	0	0
Mar. 17	,, £500 India 3% stock @ 63		315	0	0						
	,, Commission		1	5	0	June 18	,, £800 Victoria stock @ 100	c/d	800	0	0
	,, Contract stamp			6	0						
June 18	,, £800 Victoria stock @ 101		808	0	0						
	,, Commission		2	0	0						
	,, Contract stamp			2	0						
June 3	,, Commission, etc., on sales		5	10	0						
June 18	,, Do. do.		1	5	0						
	,, Contango, ¼% on £800		2	0	0	June 18	,, Cash		23	0	0
			£1940	10	0				£1940	10	0
June 18	To £800 Victoria stock @ 100	b/d	800	0	0						

NOTE.—As the Victoria stock was purchased for £808 but is carried forward at par, i.e., at £800, T. Wilson is required to pay to the broker the decrease in value, i.e., £8 (which is included in the cash payment of £23).

A LIFE POLICY TAKEN IN SETTLEMENT OF A DEBT.

Where a life policy is taken over in settlement of a debt due, the treatment of such policy will depend upon circumstances. It may be preferable to realise the policy at its surrender value and to write the difference off to Profit and Loss Account as a bad debt. On the other hand, it may be advisable to keep the policy in force by paying the annual premiums as they become due. When the latter course is decided upon, it is prudent to maintain the book value of the policy at its surrender value. To achieve this purpose the following entries should be made :—

(1) Debit a Policy Account and credit the debtor's account with the amount of the debt.

(2) Debit Profit and Loss Account and credit a Policy Reserve Account with the difference between the surrender value of the policy and the amount of the debt, thus writing off the immediate loss by way of a bad debt.

(3) Debit Policy Account and credit Cash with the amount of the premiums when paid.

(4) After payment of the premium credit (or debit as the case may be) the Policy Reserve Account, and debit (or credit) Profit and Loss Account with such an amount as will make the balance on Policy Account, less the balance on Policy Reserve Account, equal to the surrender value of the policy at the close of the financial period. This adjusting entry is equal to the difference between the amount of the premium and the increase in the surrender value of the policy since the termination of the preceding financial accounting period.

When payment of the policy moneys becomes due, i.e., on the death of the debtor, the amount received will be debited to Cash and credited to the Policy Account; the balance of the Policy Reserve Account will be transferred to the Policy Account; and the Policy Account will be closed by transferring the balance to Profit and Loss Account. The following illustration will make this clear:—

EXAMPLE.

J. Brown, being unable to pay S. Smith his debt of £2,500, makes an assignment to him, on 1st January, 1937, of a Life Policy for £4,000 (without profits). The annual premium to keep the Policy in force is £200 payable on 31st December, and Smith, electing to pay the annual premiums when they become due, pays the first premium on 31st December, 1937. The surrender values of the policy were as follows: the 31st December, 1936, £1,440; the 31st December, 1937, £1,530; the 31st December, 1938, £1,660; and the 31st December, 1939, £1,820. J. Brown died on the 1st December, 1940, when the policy money, £4,000, is paid. Show the entries recording the transactions in S. Smith's books.

Dr. J. BROWN. *Cr.*

			£ s. d.				£ s. d.
1937 Jan. 1	To Balance .		2,500 0 0	1937 Jan. 1	By Policy A/c. .		2,500 0 0

Dr. POLICY ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
1937 Jan. 1	To J. Brown .		2,500 0 0	1937 Dec. 31	By Balance .	*c/d.*	2,700 0 0
Dec. 31	,, Cash . .		200 0 0				
			£2,700 0 0				£2,700 0 0
1937 Dec. 31	To Balance . .	*b/d.*	2,700 0 0	1938 Dec. 31	By Balance .	*c/d.*	2,900 0 0
1938 Dec. 31	,, Cash . .		200 0 0				
			£2,900 0 0				£2,900 0 0
1938 Dec. 31	To Balance . .	*b/d.*	2,900 0 0	1939 Dec. 31	By Balance .	*c/d.*	3,100 0 0
1939 Dec. 31	,, Cash . .		200 0 0				
			£3,100 0 0				£3,100 0 0
1939 Dec. 31	To Balance . .	*b/d.*	3,100 0 0	1940 Dec. 1	By Cash . .		4,000 0 0
1940 Dec. 31	,, P. and L. A/c.		2,180 0 0	,, ,,	,, Policy Reserve Account .		1,280 0 0
			£5,280 0 0				£5,280 0 0

Dr. POLICY RESERVE ACCOUNT. *Cr.*

			£ s. d.				£ s. d.
1937 Dec. 31	To Balance . .	*c/d.*	1,170 0 0	1937 Jan. 1	By P. and L. A/c.		1,060 0 0
				Dec. 31	" " "		110 0 0
			£1,170 0 0				£1,170 0 0
1938 Dec. 31	To Balance . .	*c/d.*	1,240 0 0	1937 Dec. 31	By Balance .	*b/d.*	1,170 0 0
				1938 Dec. 31	" P. and L. A/c.		70 0 0
			£1,240 0 0				£1,240 0 0
1939 Dec. 31	To Balance . .	*c/d.*	1,280 0 0	1938 Dec. 31	By Balance .	*b/d.*	1,240 0 0
				1939 Dec. 31	" P. and L. A/c.		40 0 0
			£1,280 0 0				£1,280 0 0
1940 Dec. 1	To Policy A/c .		1,280 0 0	1939 Dec. 31	By Balance .	*b/d.*	1,280 0 0

NOTE.—Alternatively, the Policy Reserve Account can be dispensed with, a balance being brought down annually on the Policy Account equal to the surrender value of the policy, any difference on the Policy Account being transferred to Profit and Loss Account.

COMPLETION ACCOUNTS.

On the sale of property it is usual for the solicitors concerned to forward accounts to their respective clients, setting out the details of the transaction and the amount due to or by the client on completion.

When the transaction is entered into, it is customary for the purchaser to pay an agreed deposit (usually 10% of the purchase price), which cannot be reclaimed if he decides not to complete the purchase. A date is fixed for completion, when the balance of the purchase price will be paid over. If the completion cannot be effected on this date owing to the fault of the purchaser, he may be charged interest on the balance of the purchase money, or if he occupies the premises, may be charged rent until the transaction is completed. No interest will be payable if the completion is postponed owing to the fault of the vendor.

In addition to the actual price of the property, the purchaser may have to compensate the vendor for certain payments made by him in advance, in respect of the property sold. Similarly, any expenditure which the vendor has not paid, but which has accrued during his ownership of the property (i.e., prior to date of completion), and which the purchaser will have to pay in the future, must be deducted from the total amount payable on completion.

EXAMPLE.

On 12th June, 1941, Pelham agreed to sell his leasehold house to Clarke for £2,000. Pelham received a deposit of £200, and completion was to take place on 25th June, 1941, interest to be charged at 5% per annum if completion was not then effected owing to the fault of Clarke. Fire Insurance of £1 per annum had been paid in advance to 25th December, 1941. Rates for the half year to 30th September, 1941 amounting to £15 had been paid. Ground Rent of £10 per annum less income tax, payable half yearly, had been paid to 31st March, 1941. The net Schedule A Assessment was £50. Assuming income tax to be 10s. 0d. in the £, prepare a completion account, setting out the amount paid by Clark on 15th July, 1941, the completion having been postponed to that date as Clarke was unable to find the purchase money on 25th June, 1941.

SALE OF LEASEHOLD HOUSE BY PELHAM TO CLARKE.
Dr. COMPLETION ACCOUNT ON 15TH JULY, 1941. *Cr.*

1941		£	s.	d.	1941		£	s.	d.
June 25	To Purchase Price	2,000	0	0	June 12	By Cash . .	200	0	0
July 15	,, Proportion of Fire Insurance from 15th July, 1941, to 25th December, 1941 —163 days @ £1 per annum .		8	11	July 15	,, Proportion of Ground Rent from 1st April, 1941, to 15th July, 1941, @ £5 for the half year, less tax @ 10s. 0d.—106 days .	1	9	0
	,, Proportion of Rates from 15th July, 1941, to 30th Sept., 1941 —77 days @ £15 for the half year . .	6	6	3		,, Proportion of Schedule A tax from 6th April, 1941, to 15th July, 1941—£50 @ 10s. 0d. for 101 days .	6	18	4
	,, Interest @ 5% p.a. less tax @ 10s. 0d. from 25th June, 1941, to 15th July, 1941 on £1,800 — 20 days . .	2	9	4		,, Balance—Cash	1,800	17	2
		£2,009	4	6			£2,009	4	6

The above information is sometimes given in the form of a *Statement*, payments on account and allowances being deducted from monies due. In working examination questions care must therefore be exercised, as an "account" should not be submitted if a "statement" is required.

CLAIMS FOR LOSS OF STOCK.

When part of a trader's stock is destroyed by fire, its value is usually computed for the purposes of an insurance claim by preparing an estimated Trading Account. Unless the books are also destroyed, the sales and purchases since the last accounts, and the commencing stock, will be known, and if the average percentage Gross Profit to Sales for past years is computed on the Sales for the period, the balance on the account will represent the approximate stock at the date of the fire.

EXAMPLE.

M. Smith prepares accounts to 30th June each year, but on 30th September, 1940, fire destroyed the greater part of his stock. His books, which were saved, disclosed the following information :—

	£
Stock on 30th June, 1940	3,250
Purchases from 30th June to 30th September	5,500
Wages " "	2,250
Sales " "	10,000

Average percentage Gross Profit to Sales for the last three years was 25%.

Stock to the value of £700 was salvaged.

Prepare an account setting out the amount to be recovered from the insurance company.

M. SMITH.

ESTIMATED TRADING ACCOUNT FOR THE THREE MONTHS ENDED 30TH SEPTEMBER, 1940.

Dr. *Cr.*

	£		£
To Commencing Stock	3,250	By Sales	10,000
" Purchases	5,500	" Estimated Stock	3,500
" Wages	2,250		
" Estimated Gross Profit, 25% on £10,000	2,500		
	£13,500		£13,500

	£
Estimated Stock on date of fire	3,500
Less Stock recovered	700
Amount of claim	£2,800

It is usual to find an " average " clause in this type of policy, providing that if the value of the stock insured is greater than the amount insured against, the claim must be restricted to that proportion of the loss which the amount insured against bears to the value of the property. If, therefore, Smith had only insured against a loss of £2,000, he could only recover from the insurance company :—

$$\frac{2{,}000}{3{,}500} \text{ of } £2{,}800 = £1{,}600$$

and would be deemed to be his own insurer for the balance.

In preparing the normal Trading and Profit and Loss Accounts, Trading Account must be credited with the value of stock at date of fire, in order to preserve the normal rate of gross profit, the insurance company being debited with the amount recoverable, Salvaged Stock Account debited with the amount salvaged, and Profit and Loss Account debited with any loss of stock irrecoverable. Any expenses incurred in dealing with the salvaged

stock should also be debited to Salvaged Stock Account, and the account credited with the proceeds of sale of the goods. Any difference should be written off to Profit and Loss Account.

The above example of a claim against an insurance company for stock lost through fire is relatively simple and straightforward but it should be noted that in practice many other considerations might influence the computation of the claim, e.g. :—

(*a*) Any variation in the basis of valuation of stock over the period used as a basis for computation of average percentage gross profit.

(*b*) Any variation in the nature of the trade conducted by the firm over the period used as a basis for computation of average gross profit.

(*c*) Seasonal trade, which may make it not strictly correct to base the estimated gross profit for the period from the date when the final accounts were last prepared to the date of the fire on a percentage obtained from figures relating to complete years.

(*d*) Any change in the treatment of prime cost items over the period used as a basis for computation of average gross profit, e.g., the charging of productive wages or other direct expenses (or part thereof) to Profit and Loss Account in place of Trading Account during any year.

LOSS OF PROFITS INSURANCE.

Traders sometimes cover themselves against loss of profits caused by the interruption of business owing to fire. The policy will, of course, specify the precise manner in which the loss is to be computed, but it is usual to calculate a percentage on the decrease in turnover between a specified period after the fire, and the corresponding period in the previous year.

The percentage stated above must be the *lower* of the following percentages :

(1) $$\frac{\text{Sum Assured}}{\text{Turnover for 12 months preceding fire}} \times 100$$

(2) $$\frac{\text{Net Profits } \textit{plus} \text{ Standing Charges for last } \textit{financial} \text{ year}}{\text{Turnover for last } \textit{financial} \text{ year}} \times 100$$

EXAMPLE.

X Co., Ltd., prepare accounts annually to 30th September. On 28th February, 1941, their premises were destroyed by fire. The company had effected a loss of profits insurance for £20,000, the period of indemnity being six months after the fire. The profits for the year to 30th September, 1940, were £12,000 after debiting standing charges of £4,000, and the turnover for that year was £240,000. The turnover for the year to 28th February, 1941, was £250,000 (of which £100,000 related to the last six months) and that of the six months to 31st August, 1941, was £50,000. Calculate the amount recoverable from the insurance company.

	£
The turnover for the six months immediately after the fire—i.e., from 1st March to 31st August, 1941 =	50,000
The turnover for the *same* period in 1940 was £250,000 *less* £100,000 =	150,000
Decrease in turnover	£100,000

The percentage of £100,000 which may be claimed will be the lower of the following :—

(1) $\frac{£20,000}{£250,000}\times 100=8\%$.

(2) $\frac{£12,000+£4,000}{£240,000}\times 100=6.67\%$.

The claim will therefore be 6.67% of £100,000=£6,667.

COMPENSATION CLAIMS.

A claim for compensation may arise through, *inter alia* :—

(1) Compulsory acquisition of premises.
(2) Personal injuries.

(1) This type of claim usually arises when local authorities desire to obtain possession of the premises for slum clearance or road-widening purposes. The chief points to be borne in mind are :—

(*a*) Loss of beneficial interest (usually based on the purchase of three years' profits).
(*b*) Value of unexpired portion of lease.
(*c*) Loss in respect of compulsory sale of assets.
(*d*) Any premium paid for acquisition of new premises.
(*e*) Any removal expenses.
(*f*) Damages incurred through inability to complete contracts within the stipulated times.
(*g*) Estimated loss on trading which will be sustained.

(2) The chief points to be considered in preparing a claim for compensation for personal injuries are :—

(*a*) Loss of income owing to incapacity due to injuries.
(*b*) Whether or not claimant will be totally or partially disabled for life.
(*c*) Actual medical fees incurred.

SOLICITORS' ACCOUNTS

The fiduciary relationship which is usually found to exist between solicitor and client points to the need for a careful and accurate system of accounting. It had been recognised for some time that the best practice was that which kept quite separate accounts of clients' moneys and the solicitor's own moneys and this practice was accordingly followed by the large and best-known firms. Unfortunately, however, there were cases in which clients' moneys and the solicitor's own moneys had been so intermingled that it was wellnigh impossible to prepare accounts showing how the solicitor stood in relation to his clients. That such a state of affairs could arise in practice was very undesirable and the Solicitors Act, 1933, and the Solicitors' Accounts Rules,

1935, which made it compulsory for every solicitor to keep separate accounts in respect of clients' moneys and those belonging to himself, were designed to remove this possibility. The principal provisions of the rules may be summarised as follows :—

(1) Every solicitor must keep books and accounts so as to show and distinguish (*a*) moneys received from or on account of and moneys paid to or on account of each of his clients, and (*b*) moneys received and moneys paid on his own account.

(2) Every solicitor who holds or receives money on account of a client shall pay it into a current or deposit account at a bank in the name of the solicitor, in the title of which the word " Client " shall appear. Where a solicitor receives a cheque or draft representing partly a client's money and partly money due to the solicitor, he may, where practicable, split the cheque or draft and pay into the Client's Banking Account only that part which belongs to the client.

(3) The only moneys which shall be paid into the Client's Banking Account are : (*a*) client's money, (*b*) solicitor's money necessary for opening or maintaining the account, (*c*) money for replacement of sums withdrawn by accident or mistake, and (*d*) cheques or drafts representing partly client's and partly solicitor's money, which have not been split under (2) above.

(4) The only moneys which shall be withdrawn from the Client's Banking Account are : (*a*) money required for payment to or on behalf of a client or due to the solicitor from the client or drawn on the client's authority, (*b*) solicitor's money paid in under (3) (*b*) or (3) (*d*) above, and (*c*) money paid in by mistake or accident.

(5) The Council of the Law Society, either on their own motion or on written complaint, may require any solicitor to produce his books of account, bank pass books, vouchers, etc., for the inspection of any person appointed by the council.

The books to be kept will be those usually found in a complete double entry system, i.e., cash book, petty cash book, ledgers and (in place of the sales day book) a bills delivered book. Some extension of the system which pertains in ordinary commercial offices is necessary in order to comply with the principles already outlined for the separation of clients' balances. The detailed books to be kept will usually consist of the following :—

(1) Cash Book, which contains separate columns for Client's Banking Account and Solicitor's Banking Account, the former for recording the receipt and payment of all moneys belonging to clients or received or paid on their behalf, and the latter for recording moneys received on the solicitor's account (i.e., from clients on account of costs) and paid out of the solicitor's own resources. In no circumstances is it permissible to apply money belonging to one client for the purposes of another, or, in other words, to make a payment out of the Client's Banking Account without first seeing that a sufficient

part of the balance standing to the credit of that account belongs to the particular client on whose behalf the payment is made.

(2) Bills Delivered Book, which records all bills of cost delivered to clients, while in a special section at the end of the book allowances and abatements made to clients on such delivered bills are recorded.

(3) Petty Cash or Disbursements Book, which records petty cash expenditure and disbursements made on account of clients, i.e., search fees, engrossing, etc., which will ultimately be charged to clients in their bills of costs.

(4) Journal, for recording items of a special nature, for which there is no book of first entry.

(5) Clients' Ledger, which contains an account for each client and records the amounts of funds standing to the credit of clients, amounts due from clients on account of costs and disbursements made on their behalf by the solicitor.

(6) Private Ledger, which contains all the accounts not included in the Clients' Ledger, i.e., all the nominal and other impersonal accounts.

The rulings of the recommended books of account and the double entry relating to transactions between solicitor and client are illustrated in the following examples. It should be noted that the actual form of the books of account and the wording of the entries therein is in accordance with a system adopted by many solicitors, and slight points of difference from ordinary commercial practice arise, e.g., the omission of the prefixes "To" and "By," etc.

EXAMPLE I.

A solicitor has separate banking accounts for his own and clients' moneys and he keeps a Cash Book incorporating separate columns for each banking account. Set out the entries in such Cash Book in respect of the following transactions :—

19..

Jan. 17. Payment (by cheque) of £50 to Thomas, at the request of a client Williams, on account of a debt due by Williams to Thomas, the solicitor having no moneys in hand of Williams.

Jan. 19. Williams pays £200 in cash to the solicitor to meet the £50 and to discharge the balance of the debt due to Thomas.

Jan. 20. The solicitor gives a cheque to Thomas for £125, the balance of the debt due, debits Williams with costs £5, and remits the balance to him by cheque.

CASH BOOK.

Dr. RECEIPTS. PAYMENTS. *Cr.*

Date.	Client or Matter.	Particulars.	Led. Fol.	Solicitor's No. 1 A/c Bank.	Client A/c. Bank.	Date	Client or Matter.	Particulars.	Led. Fol.	Solicitor's No. 1 A/c	Client A/c
19..				£	£	19..				£	£
Jan. 19	Williams	Of you, to meet £50 paid to Thomas and to discharge balance of debt due to Thomas .		50	150	Jan. 17	Williams	Thomas on account of a debt due by Williams to Thomas .		50	
,, 20	—	Total of clients' moneys earned since 17th inst., transferred contra		5		,, 20	Williams	Thomas for balance of debt due by Williams .			125
						,, 20	Williams	Cash remitted to you being balance in hand less £5 costs .			20
						,, 20	—	Total of clients' moneys earned since 17th inst., transferred contra			5
								Balance carried down . .		5	
				£55	£150					£55	£150
		Balance brought down . .		5							

EXAMPLE II.

A solicitor has in his Client's Banking Account a balance in hand of £75, viz., £50 for Mr. Smith and £25 for Mr. Brown. He debits costs of £20 against Mr. Smith and £40 against Mr. Brown, and, both clients having given the necessary authority as to their costs, he makes a transfer from the Client's Banking Account to his Solicitor's No. 1 Banking Account. Set out all the appropriate entries.

BILLS DELIVERED BOOK.

PART I.—BILLS DELIVERED.

Date of Delivery	Client.	Description of Business.	Gen. Led. Fol.	Amount of Bill.	No. of Bill.	Remarks.
19..				£		
	Mr. Smith	Various matters		20		
	Mr. Brown	do.		40		

NOTE.—The total of this book will be credited to Costs Account.

CLIENTS' LEDGER.

Dr. MR. SMITH'S ACCOUNT. *Cr.*

19..	To Our Costs in various matters .		£ 20	19..	By Balance, *b/d.* .	£ 50

Dr. MR. BROWN'S ACCOUNT. *Cr.*

19..	To Our Costs in various matters .		£ 40	19..	By Balance, *b/d.* .	£ 25

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		Dr.	*Cr.*
19..		£	£
	Solicitor's No. 1 Banking Account . . . *Dr.*	45	
	To Clients' Banking Account		45
	Client's money earned and now transferred— £		
	Mr. Smith 20		
	Mr. Brown 25		

CASH BOOK.

Dr. RECEIPTS. PAYMENTS. *Cr.*

Date.	Client or Matter	Particulars.	Led. Fol.	Solicitor's No. 1 A/c Bank.	Client A/c Bank.	Date.	Client or Matter.	Particulars.	Led. Fol.	Solicitor's No. 1 A/c	Client A/c
19..				£	£	19..				£	£
		Balance brought down . .			75			Total of client's moneys earned since —, transferred contra . .			45
		Total of clients' moneys earned since —, transferred contra . .			45						

NOTE.—As the balance in the solicitor's hands on account of Mr. Brown is £25 only, no more than that amount can be transferred from Client's Account to Solicitor's No. 1 Account for costs of that client.

The Solicitors Act, 1941, provides for the compulsory audit of solicitors' accounts and the auditor must state in his report whether the solicitor or his firm has complied with the provisions of the Solicitors' Account Rules, 1935.

EXERCISE 13

A. Under agreement with his firm, dated 31st December, 19.. a manager is entitled to 5% on the net profits after charging such commission. From the following figures prepare the Commission Account and adjusted Profit and Loss Account.

	£	s.	d.		£	s.	d.
To Salaries and Wages .	1,296	5	9	By Gross Profit brought from Trading Account	4,037	0	2
,, Freight and Cartage .	564	19	9	,, Discount Account (balance) . .	26	0	9
,, General Expenses .	463	5	1				
,, Bad Debts . .	517	14	9				
,, Bank Interest and Charges . .	25	16	4				
,, Depreciation :— Lease £325 0 0; Furniture 69 9 3	394	9	3				
,, Balance—Net Profit .	800	10	0				
	£4,063	0	11		£4,063	0	11

B. What are the chief differences between a Receipts and Payments Account and an Income and Expenditure Account ? Is it possible to reconcile the one with the other ? If so, state the necessary adjustments.

C. Why does a Receipts and Payments Account sometimes give a wrong impression ? Illustrate your answer.

D. Could you rely upon a Receipts and Payments Account in the case of a dentist for the purpose of ascertaining the profit or loss ? Give reasons for your answer.

E. The following particulars relate to the Chilworth Literary Society for the year ended 31st December, 1940: Subscriptions received, £108; interest received on investment, £40; net proceeds received from lectures and concerts, £232; rent paid for use of hall, £21; petty cash payments, £10; advertising paid, £21; printing expenses paid, £12 10s.

The Society holds ten 4% Debentures of £100 each in the Universal Library, Ltd. As on 31st December, 1940, the Society owed £8 for rent of hall and £9 10s. for printing.

Prepare the Society's annual Statement of Account for the year ended 31st December, 1940. Ignore Income Tax.

F. Discuss the method of construction of interim stock accounts and their advantages.

G. It is often advisable in certain businesses to have a weekly trading and profit and loss account. Outline briefly how you would prepare such accounts, and in particular how you would deal with stock, an actual weekly stocktaking not being practicable.

H. The directors of a large retail trading company, being desirous of obtaining an approximate trading and profit and loss account every month, request you to instruct the secretary as to what is necessary in the circumstances. Stock is only taken once a year, and there are six departments. What would be your advice, especially as regards the ascertainment of the approximate value of the stock each month ?

I. The United Coal Company, Ltd., are granted a lease of 21 years at a minimum rent of £4,000 per annum merging into a royalty rent of 6d. per ton of coal raised.

During the first year the output was		90,000	tons.
During the second year	„ „	160,000	„
And during the third year	„ „	250,000	„

Make the necessary journal entries, and write up the personal and nominal ledger accounts affected.

J. Leslie Scott, colliery proprietor, leased the Cross Keys Colliery to David Jones. Under the lease a royalty of 6d. per ton is payable on all coal raised. The annual minimum or dead rent payable was agreed at £1,500, with power to recoup short workings during the first four years. Coal raised was as follows: First year, 42,500 tons; second year, 43,000 tons; third year, 50,000 tons; fourth year, 84,000 tons.

Record the above in the books of David Jones.

K. On 1st January, 1938, a company took a lease of a colliery upon a minimum rent of £300 merging into a royalty of 6d. per ton with power to recoup short workings over the first three years of the lease.

The annual output of the colliery for the first three years was as follows :—

1938	6,000 tons.
1939	13,000 „
1940	15,000 „

You are required to show how the Landlord's, Short Workings, and Royalty Accounts would appear in the company's books.

L. What do you understand by the terms Dead Rent, Royalties, and Short Workings ?

M. What are the main features of hire purchase agreements, and how would you show in the accounts the total amounts due under such agreements, and the various instalments payable from time to time thereunder ?

N. A colliery company purchases a number of waggons on hire-purchase terms, payment being made by half-yearly instalments over a period of three years. Explain, by means of *pro-forma* entries, how the half-yearly instalments will be dealt with in the accounts of the colliery company.

O. On 1st January, 1938, A. Jones purchases from the Rusher Engine Co., on the hire-purchase system, a gas-engine, to be paid for in three instalments, viz., £31 10s. on the 31st December, 1938 and 1939, and the exact balance due on 31st December, 1940. The present cash value of the engine is £84 5s., and the interest charged is at the rate of 6% per annum. Set out the account of A. Jones as it would appear in the books of the Rusher Engine Co.

P. The proprietor of a musical instrument warehouse, who does a large hire purchase trade, asks you to advise him as to the proper form in which he should keep his personal ledger accounts (with his customers).

Draft a specimen account ; also state what special points there are (if any) in the preparation of Trading and Profit and Loss Accounts and Balance Sheet in a business of this nature.

Q. Make up the voyage account of the s.s. *Devonia* from the following information, and show the amount of dividend receivable by the holder of a share in the ship. Commenced loading at Newport, 1st February, 1941. Freight on coal to Buenos Ayres, £9,462 ; Passage Money outwards, £314 ; Disbursements : Newport, £878 ; Buenos Ayres, £2,940 ; London, £2,670 ; Hull, £1,270 ; Wages for voyage, £3,254 ; Bunker Coals, £5,891 ; Insurance on Steamer for one year, £8,640 ; Insurances on Freight, etc., for the Voyage, £1,657 ; Freight on Homewards Cargo, £18,519 ; Passage Money, £464 ; Mail Money, £41 ; Manager's Commission, 2% on gross earnings, and 5% on net profits before charging the latter commission : £1,500 to Reserve. Completed discharge, 30th June, 1941.

R. Debentures for £10,000 in the Junction Railway Co., bearing interest at 5% per annum, are purchased on 1st March, for £6,877 18s. 6d., including brokerage and stamps. The interest is payable half-yearly on 1st May and 1st November. The debentures are sold on the following 1st December at 69¼, less brokerage at $\frac{3}{16}$%. Show the Investment Account recording these transactions. Ignore Income Tax and calculate brokerage on nominal value.

S. S. Morris, being unable to pay M. Cohen his debt of £1,200, makes an assignment to him, on 24th March, 1938, of a Life Policy for £1,000. The annual premium of £50 on the policy is payable on 31st December, and Cohen elects to keep the policy in force and to pay the premiums as and when due. The surrender values of the policy were as follows: 24th March, 1938, £740; 31st December, 1938, £750; 31st December, 1939, £787; 31st December, 1940, £829; 31st December, 1941, £880. Morris died on 4th April, 1942, and the policy moneys were duly received by Cohen. Show the transactions in Cohen's books.

T. On 20th January the Y. Z. Investment Trust purchased 2,000 shares in Dud Mines Limited, at 16s. per share. The Contract Note showed as follows:

	£	s.	d.
2,000 shares at 16s.	1,600	0	0
Brokerage, 3d. per share	25	0	0
Stamp and transfer fee	16	2	6
Contract stamp		4	0
	£1,641	6	6

On settlement day, 30th January, the purchasers carry over the purchase; the making-up price is 15s. 6d. per share, and the contango charge is ½d. per share. The difference on the settlement is duly paid.

On 10th February the Y. Z. Investment Trust sell the 2,000 shares. The Sale Note appears as follows:

		£	s.	d.
Sold for Account 15th February 2,000 shares at 16s. 7½d.		1,662	10	0
Less Brokerage (on closing, nil) ..				
Contract Stamp	4 0		4	0
		£1,662	6	0

Prepare an account as in the books of the Y. Z. Investment Trust showing the above transactions.

U. On 31st December, 1940, a fire occurred on the premises of a limited company which carried on the business of general house furnishers. From the most important books, which were not destroyed, it was possible to obtain the following particulars:—

	£
Sales from 1st January to 31st December, 1940	128,000
Purchases from 1st January to 31st December, 1940	84,000
Stock on hand at 31st December, 1939	23,600
The Gross Profit for the past five years had averaged 35% on turnover.	

The value of the salvaged stock was agreed at £3,000. Assuming all to be in order, draft a statement showing amount of the claim upon the insurance company.

V. A solicitor has separate banking accounts for his own moneys and for clients' moneys. You are required to set out the entries in the Cash Book and Ledger in respect of the following transactions:—

19..

July 19—Payment by cheque of £30 to Brown, at the request of a client Green, on account of a debt due by Green to Brown, the solicitor having no moneys in hand of Green.

„ 24—Receipt by the solicitor from Green of £60 to meet the advance of £30 and to discharge the balance of £20 due to Brown.

„ 27—The solicitor debits costs to Green, £20, and these costs are agreed by the client.

„ 31—The appropriate transfer is made in respect of client's moneys earned during July.

CHAPTER XIV

SINGLE ENTRY BOOK-KEEPING ; CARD AND LOOSE-LEAF LEDGERS ; MECHANICAL METHODS OF BOOK-KEEPING

THE main purpose of this work is the exposition of the principles of double entry book-keeping, but it would be incomplete unless some consideration were given to other phases of accounts, and particularly to what is known as "Single Entry" book-keeping. The term "Single Entry" as applied to accounts is used with much indefiniteness, and denotes varied systems of book-keeping, but pure "Single Entry" recognises only the personal aspect of transactions, and, consequently, the only essential books are the personal ledgers for recording transactions with debtors and creditors. In practice, however, a Cash Book is invariably kept, but, with this exception, the impersonal aspect of transactions is usually left entirely unrecorded.

What is Single Entry ?

The term "Single Entry" is applied generally to any system which does not provide for the twofold aspect of transactions. Broadly speaking, there is no basic principle underlying such so-called systems, and naturally there cannot be any fixed rules where there is really no definite system.

So-called single entry systems may thus include :—

(1) The use of a Cash Book to record receipts and payments, this being the only book of account. Unpaid invoices are kept on a file until they are paid, when they are transferred to a "paid" file. Where sales are mainly for cash, only a "daily takings" book is kept, wherein are recorded the amounts of cash taken daily over the counter, whilst a memorandum book is used to record "sales on credit," the entries being cancelled as and when the amounts owing are paid.

(2) The use of a Cash Book for receipts and payments, together with a Sales Day Book and a Debtors' Ledger for credit sales, purchases being dealt with as in (1). Discounts allowed are entered direct in the Debtors' Ledger ; they may be noted in the Cash Book.

(3) The use of a Cash Book, Sales and Purchases Books, and Debtors' and Creditors' Ledgers. Discounts allowed and received are recorded direct in the personal ledgers as in (2).

The first two methods are hardly worthy of being called "systems," but they are often met with in small retail businesses. The third method, however, is really a combination of single entry and a little double entry, inasmuch as the method of recording debit entries for receipts from debtors in the Cash Book, and the equalising credit entries in the debtors' personal accounts, together with similar entries for creditors, does recognise the twofold aspect of cash transactions. The system takes no cognisance of the impersonal aspect of transactions other than cash, however, and thus no ledger accounts are opened to record total purchases, sales, or expenditure, etc., or the value of assets and property, such as machinery, plant, fixtures, etc.

Advantages of Double Entry over Single Entry.

The only satisfactory method of book-keeping is the Double Entry system, and its advantages over any other method may be summarised as follows :—

(1) There is an equalising debit entry for every credit entry, and *vice versa*, and, after the postings to the ledger are completed, a Trial Balance containing a list of the balances of the ledger accounts may be prepared in order to prove, by the agreement of its two columns, the arithmetical accuracy of the books.

(2) Both aspects of every transaction—the impersonal as well as the personal—are properly recorded in books of account.

(3) The balances of the nominal accounts, representing income or profits and expenditure or losses, may be collected and grouped together, at any particular time or at the end of a trading period, in one classified account—the Profit and Loss Account. An excess of the credits over the debits in this account will show the final net profit, whilst any excess of the debits over the credits will indicate a net loss. Further, this account shows, in addition to the net results of the trading for the period, the sources of the profits or losses, and, by comparison of the account with similar accounts for other periods, makes it possible to ascertain the causes of fluctuations in the profits, etc.

(4) The financial position of the trader is readily ascertained by the preparation of a Balance Sheet in

which the whole of the assets, liabilities, and capital of the business are grouped. The insertion of the balance of the Profit and Loss Account in this statement and the agreement of the totals of the assets and liabilities proves the arithmetical accuracy of the final accounts.

(5) Although the double entry system does not, in itself, disclose errors of omission, compensating errors, and errors of principle, yet the periodical balancing of the books does reduce the possibility of inaccuracies, and considerably minimises the risk of fraud.

When single entry methods are adopted, not one of these advantages can be obtained.

The Ascertainment of Profits by Single Entry.

Generally speaking, profits (or losses) are ascertained, under the single entry system, by a comparison of the value of the net assets at two specified dates, after taking into account additions to, or withdrawals from, capital during the period. The difference between these two net values represents the profit or loss, according to whether there is an increase or decrease in the figures. A statement thus prepared is usually termed a "Statement of Affairs," but sometimes the term "Statement of Position" is used to distinguish a statement of this kind from a Statement of Affairs in Bankruptcy.

The following example illustrates the method:—

EXAMPLE.

A, *B*, and *C*, trading in partnership, keep their books by single entry. Partners are entitled to 5% per annum interest on the amounts standing to their credit at the beginning of each year, and *B* and *C* are entitled to £300 and £200 per annum respectively by way of salary. The remaining profits are to be shared, *A* ½, *B* ⅓, *C* ⅙. On 1st January, 19.., their capital accounts were: *A*, £2,760; *B*, £1,080; *C*, £120, and their assets included plant valued at £820. In the half-year ended 30th June, 19.., *B* and *C* had received their salaries, and they had also drawn at the end of each month: *A*, £61 10s.; *B*, £34 10s.; *C*, £25 10s. They had bought further plant costing £220, and now valued the whole at £950. Creditors are £1,870; Cash, £460; Debtors, £3,040; Stock, £1,890. Prepare statements showing the profit for the half-year, and the partners' Capital Accounts.

STATEMENT OF AFFAIRS

As at 1st January, 19..

	£		£
Capital Accounts—		Net Assets	3,960
A	2,760		
B	1,080		
C	120		
	£3,960		£3,960

STATEMENT OF AFFAIRS

As at 30th June, 19..

	£		£	
Creditors	1,870	Plant, 1st Jan. .	820	
		Less Depreciation	90	
			730	
Balance—Net Value of Assets .	4,470	*Add* Additions .	220	
				950
		Stock		1,890
		Debtors		3,040
		Cash		460
	£6,340			£6,340

STATEMENT OF PROFITS

For the half-year ending 30th June, 19..

	£	£		£	£	£
To Balance *c/d*. . .		1,489	By Net Assets, 30th June		4,470	
			Less value at 1st Jan.		3,960	
			Net Increase . . .			510
			„ Cash withdrawn—	Salaries.	Personal.	
				£	£	
			A . .	..	369	369
			B . .	150	207	357
			C . .	100	153	253
		£1,489				£1,489
To Interest on Capital—			By Balance *b/d*.			1,489
A	69					
B	27					
C	3	99				
„ Partners' Salaries—						
B	150					
C	100	250				
„ Divisible Profit .—						
A, one-half of £1,140 .	570					
B, one-third „ „ .	380					
C, one-sixth „ „ .	190	1,140				
		£1,489				£1,489

PARTNERS' CAPITAL ACCOUNTS.

	A.	*B.*	*C.*	Total.
	£	£	£	£
Balances at 1st Jan., 19..	2,760	1,080	120	3,960
Add Interest on Capital	69	27	3	99
Salaries	—	150	100	250
Net Profit	570	380	190	1,140
	3,399	1,637	413	5,449
Deduct Drawings	369	357	253	979
Balances at 30th June, 19..	£3,030	£1,280	£160	£4,470

It will be realised that the foregoing method of arriving at the trading profits is not satisfactory. The more obvious disadvantages are—

(1) The impossibility of proving the arithmetical accuracy of the books.

(2) The fact that nominal accounts are not kept means that much of the information has to be ascertained from memoranda or from sources other than actual accounts.

(3) Fraud may be more easily committed owing to the absence of any adequate check.

(4) There is an absence of adequate information as to the sources of the profits or of the nature and amount of the expenses incurred.

Where, however, a cash book as well as the personal ledgers has been kept, it may be possible to compile Trading and Profit and Loss Accounts on double entry principles.

THE COMPILATION OF FULL FINAL ACCOUNTS FROM SINGLE ENTRY BOOKS

In order to prepare full detailed final accounts from single entry books it is, first of all, necessary to prepare a Statement of Affairs as at the commencement of the period for which it is desired to prepare the accounts. This statement must be compiled from such memoranda, etc. (including the trader's memory), as may be available, and although complete reliance cannot always be given to such information, careful investigation will probably produce fairly approximate results.

Estimates will probably have to be made of the values of such assets as plant, fixtures and fittings, and stock, although,

in many cases, detailed lists of opening and closing stocks are made.

Analytical summaries of the Cash Book and personal ledgers must be made to ascertain the "totals" of the various classes of transactions and the expenditure, etc., for the period. These summaries may be in the form illustrated on page 584. It will be noted that columns are provided for the totals of each page of the Cash Book and for the totals of each personal account, thus ensuring the arithmetical accuracy of each stage of the work. In some cases, analytical Cash Books are kept, ruled similarly to the summary set out on page 584. When this is the case, the summary may be dispensed with, the analysis being already maintained in the Cash Book.

Upon completion of these summaries, the totals obtained are amalgamated with the commencing statement of affairs so as to form a complete Trial Balance. In preparing the latter, care must be observed to insert correctly—

(1) The commencing capital and additions thereto (if any).
(2) The commencing values of assets, such as plant, fittings and fixtures, stock, etc.
(3) The totals of the various transactions, e.g., purchases, sales, returns inwards and outwards, expenses, private drawings, etc.
(4) The closing balances of cash, debtors and creditors.

If the work is carefully and accurately performed the total of the debit and credit columns of the Trial Balance should agree. It may be observed that the commencing totals of cash, debtors and creditors, will not, of course, appear in the Trial Balance.

The next step is to ascertain what amounts (if any) are outstanding or paid in advance. Adjustments for these items, provision for depreciation and reserves for bad debts must be made, and when the value of the closing stock is obtained, the Trading and Profit and Loss Accounts, and Balance Sheet may be prepared in the usual manner.

It must be emphasised, however, that in analysing the Cash Book and Debtors' Ledger, particular care must be taken to see that any expenditure in respect of assets is properly capitalised and not charged to revenue as trading purchases or expenses.

The following example illustrates the method of procedure. It must be added, however, that whilst the method is based on double entry principles and enables a very close approximation of the true results and position to be obtained, yet it does not yield the same satisfaction as accounts prepared from a complete set of double entry books.

ANALYSIS OF DEBTORS' LEDGER

For year ending 31st Dec., 19..

Fo.	Name.	Debits. Commencing Balance.	Debits. Sales.	Debits. Total.	Credits. Cash received.	Credits. Discount.	Credits. Returns.	Credits. Bad Debts.	Credits. Closing Balance.	Credits. Total.
		£	£	£	£	£	£	£	£	£
1	A. Brown . .	25	185	210	152	8	15	..	35	210
	etc.	etc.	etc.	etc.	etc.	etc.	etc.	etc.	etc.	etc.
		£1,725	£7,420	£9,145	£6,740	£325	£180	£50	£1,850	£9,145

ANALYSIS OF CREDITORS' LEDGER

For Year ending 31st Dec., 19..

Fo.	Name.	Debits. Cash Paid.	Debits. Discounts.	Debits. Returns.	Debits. Closing Balance.	Debits. Total.	Credits. Commencing Balance.	Credits. Purchases.	Credits. Total.
		£	£	£	£	£	£	£	£
2	C. Attic .	156	8	16	..	180	22	158	180
	[illegible]	etc.	etc.	etc.	etc.	etc.	etc.	etc.	etc.
		£5,780	£210	£65	£1,450	£7,505	£1,560	£5,945	£7,505

ANALYSIS OF CASH BOOK

For Year ending 31st Dec., 19..

Page.	Debits. Balance on 1st Jan.	Debits. Payments by Debtors.	Debits. Cash Sales.	Debits. Total.	Credits. Payments to Creditors.	Credits. Cash Purchases.	Credits. Wages.	Credits. Rent and Rates.	Credits. Trade Expenses.	Credits. Private Drawings.	Credits. Closing Balance.	Credits. Total.
	£	£	£	£	£	£	£	£	£	£	£	£
1	720	510	20	1,250	420	..	12	..	6	10	..	448
etc.	..	etc.	etc.	etc.	etc.	etc.	etc.	etc.	etc.	etc.	1,045	etc.
	£720	£6,740	£860	£8,320	£5,780	£250	£410	£200	£275	£360	£1,045	£8,320

In practice, additional columns may have to be provided for other classes of receipts and expenditure, but the foregoing *pro forma* accounts illustrate the method of analysis. After these analytical summaries are completed, the next step will be the amalgamation of the three summaries with the opening

" Statement of Affairs," so as to compile a complete Trial Balance Let us assume that the following statement shows the position at the beginning of the year.

STATEMENT OF AFFAIRS

AS AT 1ST JANUARY, 19..

Liabilities.	£	*Assets.*	£
Sundry Creditors	1,560	Plant and Machinery . .	1,250
		Fittings and Fixtures . .	120
		Stock-in-trade . . .	760
		Sundry Debtors . . .	1,725
Capital	3,015	Cash at Bank	720
	£4,575		£4,575

The Trial Balance will then be completed in the following manner :—

TRIAL BALANCE.

AS AT 31ST DECEMBER, 19..

	Dr. £	*Cr.* £
Capital		3,015
Plant and Machinery	1,250	
Fittings and Fixtures	120	
Stock-in-Trade, 1st January	760	
Sales		7,420
Discounts Allowed	325	
Returns Inward	180	
Bad Debts	50	
Sundry Debtors	1,850	
Discounts Received		210
Returns Outward		65
Purchases	5,945	
Sundry Creditors		1,450
Cash Sales		860
Cash Purchases	250	
Wages	410	
Rent and Rates	200	
Trade Expenses	275	
Drawings	360	
Cash at Bank, 31st December	1,045	
	£13,020	£13,020

Assuming that £50 was owing for Rent, and £20 had been paid in advance for Rates on 31st December, and that provision has to be made for depreciation at 10 per cent. per annum on

Plant and Machinery, and 5 per cent. per annum on Fittings and Fixtures, and assuming also that the closing stock amounted to £820, the final accounts will appear as follows :—

TRADING AND PROFIT AND LOSS ACCOUNTS

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

			£		£		£
To Stock at 1st Jan. .			760	By Sales .	7,420		
	£			*Less* Returns	180		
„ Purchases .	5,945						7,240
Less Returns	65			„ Cash Sales . . .			860
			5,880	„ Stock at 31st Dec. .			820
„ Cash Purchases . .			250				
„ Wages . . .			410				
„ Gross Profit . .		c/d.	1,620				
			£8,920				£8,920
To Rent and Rates [£200+£50−£20] .			230	By Gross Profit . .		b/d.	1,620
„ Expenses . . .			275	„ Discounts Received .			210
„ Discounts Allowed .			325				
„ Bad Debts . . .			50				
„ Depreciation—							
Plant and Machinery			125				
Fittings & Fixtures .			6				
„ Net Profit . . .			819				
			£1,830				£1,830

BALANCE SHEET

AS AT 31ST DECEMBER, 19..

	£	£		£	£
Liabilities.			*Assets.*		
Sundry Creditors .		1,450	Plant and Machinery .	1,250	
Rent accrued . .		50	*Less* Depreciation .	125	
Capital :					1,125
Balance at 1st Jan. .	3,015		Fittings and Fixtures .	120	
Add Profit . .	819		*Less* Depreciation .	6	
					114
	3,834		Stock-in-Trade . .		820
Less Drawings. .	360		Sundry Debtors . .		1,850
		3,474	Cash at Bank . .		1,045
			Rates paid in advance .		20
		£4,974			£4,974

The adjustments for Rent and Rates have been shown in brackets against the particular item in the Profit and Loss Account, in order to illustrate the short method of arriving at the correct debit thereto. The account for Rent and Rates

(assuming that only one account is used for these expenses) would, however, appear as follows :—

Dr. RENT AND RATES. *Cr.*

19..			£	19..			£
Dec. 31	To Cash . .		200	Dec. 31	By Rates paid in advance .	*c/d.*	20
„ 31	„ Rent accrued .	*c/d.*	50	„ 31	„ Profit and Loss Account .		230
			£250				£250
19..				19..			
Jan. 1	To Rates paid in advance . .	*b/d.*	20	Jan. 1	By Rent accrued	*b/d.*	50

An Alternative Method.

In the case of those businesses where neither debtors' nor creditors' ledgers are kept, a complete analysis of the purchases and sales transactions cannot be made. The Cash Book is analysed in the manner shown on page 584. The amount of the total purchases for the period is arrived at by ascertaining (from the cash analysis) the total amount paid to creditors during the trading period, adding to this figure the amount owing to creditors at the end of the period, and deducting therefrom the amount owing to creditors at the commencement of the period ; the resulting figure will represent the total purchases for the period. The total sales are ascertained in a similar manner.

EXAMPLE.

A and *B* are in partnership, and keep their books by single entry. They share profits and losses in the proportions of three-fifths and two-fifths respectively, and instruct you to prepare their Balance Sheet as at 30th June, 1941, together with a Profit and Loss Account for the year ended on that date.

Upon analysing the firm's Cash Book for that period you find the following, viz. :—

	£	s.	d.
Bank Balance, 1st July, 1940	400	0	0
A's Drawings	450	0	0
B's do.	300	0	0
Paid to Trade Creditors (including Bills Payable) .	3,800	0	0
Wages	1,100	0	0
Salaries	500	0	0
Other Trade Expenses	1,325	10	0
Received from Trade Debtors (including Bills Receivable)	5,364	10	0
Receipts from Cash Sales	1,581	0	0

The respective capitals of *A* and *B* at 1st July, 1940, were £4,000 and £1,000 Particulars of the other Assets and Liabilities of the firm are as follows, viz. :—

	1st July, 1940. £ s. d.	30th June, 1941. £ s. d.
Stock on hand	1,980 0 0	2,500 0 0
Debtors	2,500 0 0	1,935 10 0
Creditors	2,200 0 0	700 0 0
Bills Receivable	500 0 0	700 0 0
Business Premises	2,000 0 0	2,000 0 0
Bills Payable	300 0 0	
Office Furniture	120 0 0	120 0 0

Under the Partnership Deed, 5% per annum interest on Partners' Capital is to be a charge to Profit and Loss Account (ignore drawings), and *B* is also entitled to be credited with a commission of 6% per annum upon the net profits divisible between the partners *after* charging such commission and interest on Capital.

Reserve £150 for Doubtful Debts, and write off 5% depreciation on Business Premises and Office Furniture.

The totals of the Purchases and Credit Sales for the year are ascertained in the following manner :—

Purchases.	£	£ s. d.	*Sales.*	£	£ s. d.
Paid to Creditors		3,800 0 0	Debtors' Payments		5,364 10 0
Creditors at end—			Debtors at end—		
Open Accounts		700 0 0	Open Accounts		1,935 10 0
Bills Payable		*nil*	Bills Receivable		700 0 0
		£4,500 0 0			£8,000 0 0
Deduct creditors at commencement—			Deduct debtors at commencement—		
Open Accounts	2,200		Open Accounts	2,500	
Bills Payable	300		Bills Receivable	500	
		2,500 0 0			3,000 0 0
Purchases for Year		£2,000 0 0	*Sales for Year*		£5,000 0 0

As the closing Bank Balance is not given, it is necessary to prepare a summary of the Cash Book in order to ascertain this.

Dr. SUMMARY OF CASH BOOK. *Cr.*

		£ s. d.			£ s. d.
To Commencing Balance		400 0 0	By *A's* Drawings		450 0 0
„ Receipts from Debtors		5,364 10 0	„ *B's* Drawings		300 0 0
„ Cash Sales		1,581 0 0	„ Payments to Creditors		3,800 0 0
			„ Wages		1,100 0 0
			„ Salaries		500 0 0
		7,345 10 0	„ Trade Expenses		1,325 10 0
Balance, Bank Overdraft	*c/d.*	130 0 0			
		£7,475 10 0			£7,475 10 0
			By Overdraft	*b/d.*	130 0 0

TRIAL BALANCE.
30th June, 1941.

	Dr. £	s.	d.	Cr. £	s.	d.
Capital—*A*				4,000	0	0
,, *B*				1,000	0	0
Stock at 1st July, 1940	1,980	0	0			
Debtors	1,935	10	0			
Creditors				700	0	0
Bills Receivable	700	0	0			
Business Premises	2,000	0	0			
Office Furniture	120	0	0			
A—Drawings	450	0	0			
B ,,	300	0	0			
Wages	1,100	0	0			
Salaries	500	0	0			
Trade Expenses	1,325	10	0			
Bank Overdraft				130	0	0
Cash Sales				1,581	0	0
Credit Sales				5,000	0	0
Purchases	2,000	0	0			
	£12,411	0	0	£12,411	0	0

TRADING AND PROFIT AND LOSS ACCOUNTS
For the Year ended 30th June, 1941.

Dr.		£	s.	d.	Cr.		£	s.	d.
To Stock at 1st July, 1940		1,980	0	0	By Credit Sales		5,000	0	0
,, Purchases		2,000	0	0	,, Cash Sales		1,581	0	0
,, Wages		1,100	0	0	,, Stock at 30th June 1941		2,500	0	0
,, Gross Profit	*c/d.*	4,001	0	0					
		£9,081	0	0			£9,081	0	0
To Trade Expenses		1,325	10	0	By Gross Profit	*b/d.*	4,001	0	0
,, Salaries		500	0	0					
,, Reserve for Doubtful Debts		150	0	0					
,, Depreciation— Business Premises		100	0	0					
Office Furniture		6	0	0					
,, Balance	*c/d.*	1,919	10	0					
		£4,001	0	0			£4,001	0	0
To Interest on Capital:					By Balance	*b/d.*	1,919	10	0
A		200	0	0					
B		50	0	0					
,, *B's* Commission $\frac{6}{106}$* of £1,669 10s.		94	10	0					
,, Capital Accounts: *A*, $\frac{3}{5}$th of £1,575		945	0	0					
B, $\frac{2}{5}$th ,, ,,		630	0	0					
		£1,919	10	0			£1,919	10	0

* For explanation of method of calculation, see Chapter XIII, page 525.

PARTNERS' CAPITAL ACCOUNTS.

	A £	s.	d.	B £	s.	d.
By Balance at 1st July, 1940	4,000	0	0	1,000	0	0
Add Interest	200	0	0	50	0	0
„ Commission				94	10	0
„ Profit	945	0	0	630	0	0
	5,145	0	0	1,774	10	0
Deduct Drawings	450	0	0	300	0	0
Balance at credit, 30th June, 1941	£4,695	0	0	£1,474	10	0

BALANCE SHEET
AS AT 30TH JUNE, 1941.

Liabilities.	£	s.	d.	£	s.	d.	*Assets.*	£	s.	d.	£	s.	d.
Bank Overdraft				130	0	0	Business Premises	2,000	0	0			
							Less Depreciation	100	0	0			
											1,900	0	0
Sundry Creditors				700	0	0	Office Furniture	120	0	0			
							Less Depreciation	6	0	0			
Capital Accounts—											114	0	0
A	4,695	0	0				Stock-in-Trade				2,500	0	0
B	1,474	10	0				Sundry Debtors—						
				6,169	10	0	On open A/cs.	1,935	10	0			
							Bills Receivable	700	0	0			
								2,635	10	0			
							Less Reserve	150	0	0			
											2,485	10	0
				£6,999	10	0					£6,999	10	0

CONVERSION OF SINGLE ENTRY INTO DOUBLE ENTRY BOOKS

A trader whose books are being kept under single entry or incomplete double entry methods may be desirous of improving his system by the installation of a complete double entry system as and from a certain date. In order to do this it is necessary to proceed as follows :—

A complete set of new account books should be obtained. These books will vary in detail according to the size and nature of the business, but as single entry methods have been previously adopted a very elaborate system will probably not be required at the outset. The books necessary may include :—

(1) Private Ledger } or General Ledger.
(2) Impersonal Ledger }
(3) Purchases and Sales Ledgers.
(4) Purchases Day Book.
(5) Sales Day Book.
(6) Returns Inwards and Outwards Books.
(7) Cash and Petty Cash Books.
(8) Bills Receivable and Payable Books.
(9) Journal.

The starting-point for the conversion is the Statement of Affairs, which must be drawn up in the usual way at the date of conversion, and the opening journal entry for the new set of books will be compiled from this statement. For example, the opening entries taken from the Balance Sheet given on page 590 would be as follow :—

		£ s. d.	£ s. d.
1941 July 1	Sundries. *Dr.*		
	To Sundries—		
	Business Premises	1,900 0 0	
	Office Furniture	114 0 0	
	Stock-in-Trade	2,500 0 0	
	Sundry Debtors	1,935 10 0	
	Bills Receivable	700 0 0	
	Bank Overdraft		130 0 0
	Sundry Creditors		700 0 0
	Reserve for Bad Debts		150 0 0
	Capital Accounts—		
	A		4,695 0 0
	B		1,474 10 0
	Being assets and liabilities as at this date.		
		£7,149 10 0	£7,149 10 0

The Sales Ledger will be opened by debiting thereto the debtors as shown by the schedule prepared when compiling the Statement of Affairs, credit balances, if any, being credited. The Purchases Ledger will be opened in a similar way, and the net totals of the debtors and creditors should agree with the figures shown in the opening journal entry. The amount of the Bank Overdraft will form the opening credit balance in the Cash Book. The remaining balances will be posted to the debit or credit of appropriate accounts in the General Ledger or in the Private and Impersonal Ledgers if these are kept separately. To prove the accuracy of the postings it is advisable to extract a Trial Balance, the agreement of which indicates that the books are on an arithmetically correct double entry basis; and in future all entries must be made in accordance with the rules laid down for pure double entry book-keeping.

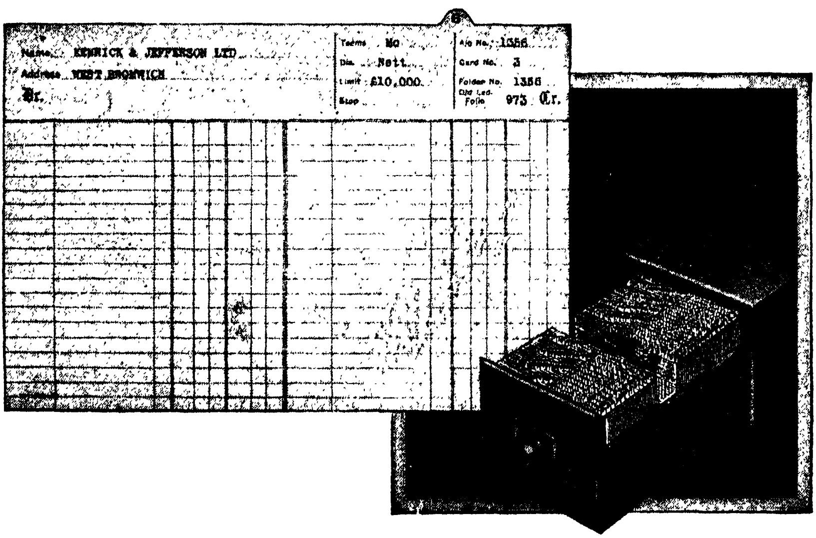
The principles of conversion are the same in every case, and the procedure will vary only in detail. For example, properly kept sales and purchases ledgers may have been in use, and in this case it will not be necessary to open new ledgers; or a suitable Cash Book may be already in use, and it will be unnecessary to replace it. These circumstances will not, however, affect the system, provided the accounts are properly ruled off and the balances brought down at the date of conversion, care being taken that no entries made under the double entry system are posted into the obsolete parts of the books.

CARD AND LOOSE-LEAF LEDGERS

A remarkable development in modern business practice has been the introduction and adoption of card and loose-leaf ledgers.

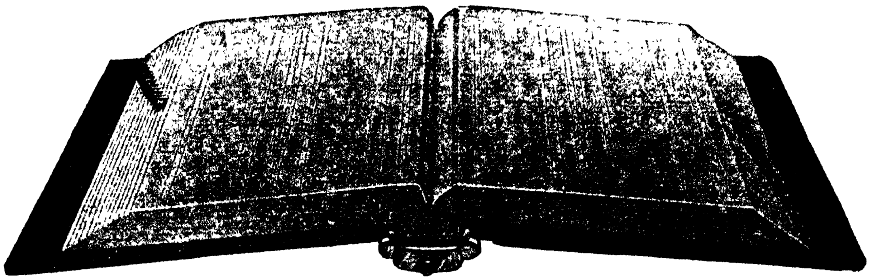
CARD LEDGERS consist of separate cards for each ledger account, kept in strict alphabetical or numerical order in a single- or multiple-drawer cabinet, in the same way as a card index. If the cards are arranged numerically, each person's account is given a definite number, and the cards are kept in numerical order, but this method necessitates the use of a separate alphabetical card-index from which to ascertain the number of each person's account. Usually, the cards are provided with a circular hole at the foot so that a self-locking rod may be passed through the whole of the cards, thus preventing their removal by any unauthorised person.

The following illustration, reproduced by courtesy of Messrs Kenrick & Jefferson, Ltd., West Bromwich, shows a card ledger in the cabinet and also a specimen card from the ledger. The card is ruled on both sides and carries a tab on which is written or printed the numerical reference, or the division of the alphabet, as the case may be. The ruling may, of course, be accommodated to suit individual requirements. That illustrated is an ordinary account ruling in Dr. and Cr. form with double cash columns, but frequently the debit and credit columns are placed side by side so that all items are entered on successive lines, the amounts being extended to the debit or credit column as the case may be. This method enables the space on the card to be utilised to its fullest extent.



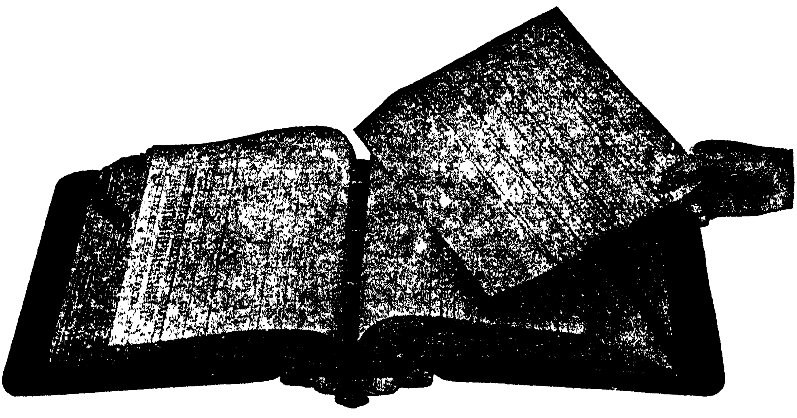
CARD LEDGER IN CABINET, AND SPECIMEN CARD.

LOOSE-LEAF LEDGERS consist of loose leaves which are fixed in binders provided with a self-locking device so that the leaves are firmly held and can be removed only by, or with the authority of, the person who has charge of the key to the ledger. Usually, these leaves are ruled in the ordinary form of an account, as in the following illustrations, also reproduced by courtesy of Messrs Kenrick & Jefferson, Ltd.



LOOSE-LEAF LEDGER.

Showing leaves locked in to prevent removal, the key being retained by a responsible official. The ruling is that of an ordinary ledger account, but may, of course, be varied to suit requirements, and for use as a journal, cash book, or other form of accounting record.



LOOSE-LEAF LEDGER—OPEN.

Showing the ledger unlocked for the insertion of an additional leaf, which is slipped into position on the steel bars.

The leaves may be arranged in any order deemed most suitable, but the two methods more generally used are—

(1) Strict alphabetical order throughout, thus avoiding the use of an index; and

(2) Alphabetical divisions for each separate letter, all surnames commencing with the same letter being kept together, and further subdivided by the insertion of vowel index cards: thus Jones would be filed under section J, vowel sub-section O; White under section W, vowel sub-section I, etc.

To prevent wrongful usage and to avoid the risk of fraud, the key of the ledger and all reserve and unused leaves are retained in the custody of a responsible official, to whom the ledger-keeper must apply for new leaves as the old ones are filled or new accounts are opened. This official also keeps a Register of Loose Leaves to record the disposal of the sheets, which are numbered consecutively. The official in charge enters the name of the account on the new leaf, and at the same time records particulars in the Register before inserting the new leaf in the ledger.

Similar precautions should be adopted in the case of card ledgers. When an account is definitely closed, or a leaf or card is completely filled up, balanced, and audited, that portion of the ledger is removed and transferred to a storage cabinet or binder, and thus only the actual cards or leaves in current use are retained in the ledger.

Advantages of Card and Loose-Leaf Ledgers.

1. The loose-leaf or card ledgers are continuous, so transfers to new ledgers never become necessary, and thus a considerable saving of time and labour is effected.

2. New leaves or cards are inserted as and when necessary, and the risk of error in transfer of accounts is reduced.

3. Every account is always consecutively arranged in its allotted position, and it is not necessary to refer to several parts of a ledger to trace the history of an account.

4. The subdivision of a ledger is accomplished very easily, and there is unlimited scope for expansion with the growth of individual accounts.

5. Only "live" accounts are retained in the ledger in current use, "dead" matter and closed accounts being transferred to storage cabinets or binders, and thus there is a great saving of time in extracting the balances at balancing dates.

6. Entries can easily be typed.

7. Generally, card and loose-leaf ledgers facilitate the work of the accounting department, adding greatly to the adaptability and mobility of the office organisation.

Disadvantages of Card and Loose-Leaf Ledgers.

1. The initial cost is greater than for bound books, but over a series of years the average cost is approximately equal,

and when the effective saving of time and labour is taken into account, the balance of advantage is with the loose-leaf and card systems.

2. In the case of card ledgers, it is sometimes found that more time is required to find the card and replace it after making the needed entries, but entries in loose-leaf ledgers are made quite as easily as in bound ledgers.

3. The risk of possible loss or accidental misplacement of cards or leaves is always present.

4. The loose-leaf and card systems provide greater opportunities for fraud than bound ledgers with fixed leaves, as it is easier to rewrite and substitute a single card or leaf than to rewrite a whole book or alter the pages in a bound book. There should not be any great risk of fraud, however, where the office organisation includes—

(1) A satisfactory internal check, including the adoption of the self-balancing system ;

(2) The ledger-keeper is a different person from those in charge of the day and cash books and other books of original entry ; and

(3) A responsible official has charge of the keys of the ledgers, and a Register of Loose Leaves, etc., is properly kept.

Even where bound ledgers are in use, there is some risk of fraudulent manipulation. Moreover, an additional safeguard is provided in the case of card and loose-leaf ledgers if a distinctive ruling is adopted for the cards and ledger leaves, for then the ledger-keeper can substitute the ordinary "stock rulings" only with difficulty.

Objection is sometimes raised that the loose leaves or cards are not such good evidence in a Court of Law as the ordinary bound ledger with fixed leaves, and this view would appear to be strengthened by the case of *Hearts of Oak Insurance Co., Ltd.*, v. *James Flower & Sons* (1935), in which the judge refused to accept a loose-leaf minute book as evidence. In this case, however, the book was in very bad condition, and anyone could remove the leaves at will, and it is unlikely that this decision would extend to loose-leaf books of account which were kept locked, the keys being in proper custody.

It may be added, however, that as compared with card ledgers, loose-leaf ledgers are more easily handled, and as the leaves are securely fixed in book form there is less risk of loss.

MECHANICAL METHODS OF BOOK-KEEPING

An important recent development in accounting practice has been the introduction of machine aids to book-keeping as a supplement to, or in place of, the older manual methods. These aids are numerous and diverse, ranging from listing and adding

machines, which compile a total of the items recorded on the machine, to book-keeping machines which write up ledger accounts and record the new balance after each transaction.

The following are the main advantages which usually accrue from the installation of machine aids to book-keeping :—

(1) Postings can be made more rapidly and with greater clarity than if done by hand.
(2) Sudden increases of work can be handled without any additions to the book-keeping staff.
(3) There is a saving in wages, since it is often possible for a book-keeping machine, operated by a single clerk, to perform the work formerly done by three or four clerks.
(4) There is, in some cases, a saving of expensive floor space.
(5) Errors are practically eliminated and checking is minimised.
(6) The work can be kept more up-to-date, and statements prepared more quickly than when the books are written up by hand.
(7) In certain machines, totals are compiled of the postings made, thus affording data for the preparation of Adjustment Accounts.
(8) Clerks released from ordinary book-keeping routine may be employed on work of a statistical nature.

The chief disadvantage of book-keeping machines is that, in many cases, their cost is high, and only comparatively large firms can profitably employ them. Before installing an expensive machine the prospective purchaser should compare the estimated running costs thereof, including operator's wages, depreciation and interest on the capital locked up in the machine, with the cost of the clerical labour which he proposes to displace. A comparison of this type may reveal that the volume of the transactions of the business is not sufficiently great to justify the installation of the machine.

It is beyond the scope of this work to give detailed descriptions of the various machines in use, but in general, the book-keeping machines are designed to type at one operation :—

(*a*) (i) Delivery Note and (ii) Invoice ;
(*b*) (i) Ledger Account and (ii) Monthly Statement.

The totals of the invoices are accumulated in the machine automatically, and thus supply the total sales to any date. Similarly the cash and returns recorded are totalled. The accuracy of the books may therefore be checked at any time by means of total accounts.

Machinery enables the "**Slip System**" to be used to advantage, the postings to the ledgers being made *from the original records*, instead of from entries in books of original entry. This system is not, however, entirely confined to machine account-

ing, but may be conveniently adapted to handwritten records, thus saving considerable time in writing up books of prime entry. Several sheets may be fastened together in sets, either interleaved with carbon paper, or with the backs of the actual sheets carboned, appropriately ruled to suit the requirements of the business, usually to serve the following purposes :—

(a) Invoice.
(b) Delivery Note.
(c) Day Book Slip.

Parts (a) and (b) will be despatched to the customer, and (c) used to make the ledger posting. The totals of all Day Book slips may be accumulated on an adding machine in order that the total sales for the period may be ascertained. The slips will then be filed, usually in a loose-leaf binder. If the slips are of different colours for different departments, sorting will be greatly facilitated.

EXERCISE 14.

A. A client instructs you to prepare Profit and Loss Account and Balance Sheet. On perusing his books you ascertain that they have not been kept upon double entry principles.

Without completing the double entry in detail, state how you would proceed to prepare the accounts.

B. A retail trader had not kept proper books of account, but from the following details you are required to ascertain the profit or loss for the year ended 31st December, 1940, and also to prepare Statement of Affairs at that date :—

	31st Dec., 1939	31st Dec., 1940
	£	£
Stock-in-Trade	1,670	1,850
Sundry Creditors	1,540	1,400
Sundry Debtors	1,120	1,050
Cash in Hand	25	120
Bank Overdraft	2,020	1,940
Bills Receivable	1,505	1,420
Fixtures, Fittings, etc.	150	150
Motor Van	190	190

The drawings during the year amounted to £260. Depreciate Fixtures, etc., by 10%, write £30 off Motor Van. As regards the Debtors, it is ascertained that £50 is irrecoverable, and a further reserve of 5% should be made. Also reserve £70 in respect of Bills Receivable.

C. M. Ravary keeps his books by "single entry." As on 31st December, 1939 and 1940 respectively, his financial position was as follows :—

	1939	1940
	£	£
Cash at Bank	457	110
Cash in Hand	36	30
Stock	1,926	2,851
Machinery and Plant	2,721	3,050
Bills Receivable	(*nil*)	324
Sundry Debtors	1,242	2,197
Sundry Creditors	3,602	4,200
Office Furniture	248	261
Private Drawings	(*nil*)	250

Prepare a statement from the above particulars, showing M. Ravary's profit for the year ended 31st December, 1940. Ignore Depreciation and Reserves.

D. A trader has kept the following books of account only, viz., Debtors' Ledger, Creditors' Ledger, and Cash Book. You are instructed to prepare his Balance Sheet as on 31st December, together with Trading and Profit and Loss Accounts for the year ended on that date. For the purposes indicated, the following statements are prepared :—

BALANCE SHEET, 1ST JANUARY.

Liabilities.	£	*Assets.*	£
Sundry Creditors	1,577	Plant and Machinery	1,081
Rent and Rates	60	Fixtures and Fittings	80
		Sundry Debtors	1,653
	1,637	Stock	804
Surplus (Capital)	2,677	Bank and Cash	696
	£4,314		£4,314

ANALYSIS OF DEBTORS' LEDGER.

	Dr. £	*Cr.* £
Cash credited		6,250
Discounts		150
Returns		145
Bad debts		42
Balances, 31st December		1,787
Balances, 1st January	1,653	
Sales	6,721	
	£8,374	£8,374

ANALYSIS OF CREDITORS' LEDGER.

	£	£
Balances, 1st January		1,577
Purchases		5,800
Cash debited	6,027	
Discounts	70	
Returns	40	
Balances, 31st December	1,240	
	£7,377	£7,377

ANALYSIS OF CASH BOOK.

	£	£
Balances on 1st January	696	
Capital Account (amounts received)	850	
Cash Credited to Debtors' Ledger	6,250	
Cash Sales	460	
Cash Debited to Creditors' Ledger		6,027
Plant and Machinery (purchase)		43
Cash Purchases		103
Wages		425
Office Expenses		225
Rents and Rates		212
Trade Expenses		95
Drawings		318
Balances on 31st December		808
	£8,256	£8,256

Stock on 31st December is £1,112; rent and rates owing on that date are £33.

E. At 1st January, 19.., W. Singler's Capital was £2,000. At 31st December of the same year he possessed the following assets: Cash in hand, £25; Cash at Bank, £500; Sundry Debtors, £1,000; Stock-in-Trade, £2,000; Horses and Carts, £250; and Fixtures and Fittings, £125. His liabilities were: Trade Creditors, £1,400. He had drawn out during the year £40 per month. He had also during the year made a profit on dealings in Stocks and Shares of £280, which he had placed in the Business Bank Account.

Prepare a Statement of Profit and a Statement of Affairs, reserving 5% on Debtors for Bad Debts; also depreciate Horses and Carts by 10%, and Fixtures and Fittings by 8%.

F. Roy, Teece, and Earl are in partnership and share profits and losses in the proportions of 5, 4, and 3, and on 1st January their capital was, Roy, £3,000; Teece, £2,800; and Earl, £2,400. At 30th June, the following is the position:—

	£
Cash in hand	36
Cash at Bank	1,000
Stock	4,000
Book Debts	5,500
Fittings, Fixtures, etc.	300
(At 1st January, Fixtures, etc., were regarded as of the value of £250; during the half-year to 30th June, £70 had been spent on additions, the value at the latter date being treated as above.)	
Sundry Creditors	960

Prepare Statement of Affairs as at 30th June; also show the profit for the half-year and the position as regards each partner. The drawings of the partners were, Roy, £390; Teece, £260; and Earl, £300; each partner is entitled to interest on his capital at the rate of 5% per annum.

G. Compare the respective merits or demerits of loose leaf or card ledgers with the ordinary ledger systems.

H. State the advantages and disadvantages with reference to the employment of loose leaf ledgers in a manufacturing concern.

I. What are the advantages and disadvantages of book-keeping machines, and what points should be considered before a mechanical system is installed?

CHAPTER XV

PARTNERSHIP DISSOLUTION ACCOUNTS; INSOLVENT PARTNERS; RULE IN GARNER v. MURRAY; STATEMENT OF AFFAIRS IN BANKRUPTCY AND DEFICIENCY ACCOUNTS; DEEDS OF ARRANGEMENT; COMPANY LIQUIDATION ACCOUNTS

THE circumstances in which partnerships may be dissolved are thus summarised by the Partnership Act, 1890 :—

Section 32. Subject to any agreement between the partners, a partnership is dissolved—

(*a*) If entered into for a fixed term, by the expiration of that term :
(*b*) If entered into for a single adventure or undertaking, by the termination of that adventure or undertaking :
(*c*) If entered into for an undefined time, by any partner giving notice to the other or others of his intention to dissolve the partnership.

In the last-mentioned case the partnership is dissolved as from the date mentioned in the notice as the date of dissolution, or, if no date is so mentioned, as from the date of the communication of the notice.

Section 33.—(1) Subject to any agreement between the partners, every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner.

(2) A partnership may, at the option of the other partners, be dissolved if any partner suffers his share of the partnership property to be charged under this Act for his separate debt.

Section 34. A partnership is in every case dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership.

Section 35. On application by a partner the Court may decree a dissolution of the partnership in any of the following cases :

(*a*) When a partner is certified to be a lunatic or is shown to the satisfaction of the Court to be of permanently unsound mind, in either of which cases the application may be made as well on behalf of that partner by his

committee or next friend or person having title to intervene as by any other partner:

(b) When a partner, other than the partner suing, becomes in any other way permanently incapable of performing his part of the partnership contract:

(c) When a partner, other than the partner suing, has been guilty of such conduct as, in the opinion of the Court, regard being had to the nature of the business, is calculated to prejudicially affect the carrying on of the business:

(d) When a partner, other than the partner suing, wilfully or persistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable for the other partner or partners to carry on the business in partnership with him:

(e) When the business of the partnership can only be carried on at a loss:

(f) Whenever in any case circumstances have arisen which, in the opinion of the Court, render it just and equitable that the partnership be dissolved.

In many cases, the dissolution is caused by the retirement of one partner, and in such a case, if the business is carried on by the remaining partners, the partnership accounts are affected only in as far as it is necessary to revalue the assets, etc., and adjust the partners' accounts.

After the profits to the date of the dissolution have been ascertained and credited to the accounts of the respective partners, a Revaluation Account is opened, and this account is credited with any increase in the value of the assets, and debited with any decrease, any increases or decreases in the value of the liabilities being recorded in the converse manner. The balance of the account is divided between the partners, and the outgoing partner is also credited with his proportionate share of the goodwill (if any) of the business.

If the new values are not to be retained in the books, the differences must be written off to the partners of the new firm in the new profit-sharing ratio. In this case it is unnecessary to make any alteration to the book values of the asset and liability accounts concerned; the differences between actual and book value may be carried down on the Revaluation Account and written off to the new partners' accounts, as in the example on page 196.

The outgoing partner's capital account is closed upon payment to him of the amount due, but if payment is deferred for a period, the balance of the capital account should be transferred to a loan account. Interest will be credited periodically to the loan

account according to agreement between the partners, payments being debited as and when they are made.

Where the dissolution affects one partner only, it really amounts to a retirement of that partner. In its truest sense, however, "dissolution" implies a complete dissolution of the partnership, and involves the payment of the whole of the partnership debts, and the distribution of the assets in accordance with the provisions of the Partnership Act or of the partnership agreement.

Dissolution may occur through—

(1) Mutual agreement to wind up, and close or sell the business.
(2) Conversion of the business into a limited company.
(3) Insolvency of the partnership business, or
(4) Any of the causes outlined on pages 600-601.

Retirement of One Partner.

Section 42. (1) Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with its capital or assets without any final settlement of accounts as between the firm and the outgoing partner or his estate, then, in the absence of any agreement to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since the dissolution as the Court may find to be attributable to the use of his share of the partnership assets, or to interest at the rate of 5 per cent. per annum on the amount of his share of the partnership assets.

These provisions are, as stated above, subject to any agreement, and in most cases the method to be adopted in arriving at the deceased or retired partner's share is provided by the Articles of Partnership.

EXAMPLE.

Peace, Pearce and Pearson were in partnership sharing profits in the proportion of one-half, one-quarter and one-quarter. It was provided in the partnership agreement that:

(*a*) A Policy of Survivorship Assurance be taken out on the joint lives of the partners for £12,000.
(*b*) Interest at the rate of 5 per cent. per annum was to be allowed on partners' capitals and charged on partners' drawings.
(*c*) In the event of the death of a partner the goodwill was to be valued at an amount equal to three years' purchase of the average "super profits" of the last two years. The average normal profits are to be taken as £10,000.
(*d*) In addition to his share of goodwill the deceased partner's representatives were to receive the amount of his capital at the date of the last Balance Sheet and his share of profits to date of death estimated upon the average profits of the last two years.

(e) Interest to be allowed at 5 per cent. per annum on the amount ascertained as being due to the deceased partner's representatives from date of death to date of payment.

The results for the last three years ended 31st December, 1940, were as follows:—1938, Loss £4,500; 1939, Profit £14,750; 1940, Profit £17,250. Pearson died on 31st March, 1941. His drawings to date of death were: 31st January, £240, 28th February, £240, 30th March, £217. His capital as shown by the last Balance Sheet was £16,000.

From the above information prepare an account showing the amount paid to Pearson's representatives, assuming a settlement was made at 30th September, 1941. Calculate interest to the nearest month.

STATEMENT SHOWING AMOUNT DUE TO PEARSON'S PERSONAL REPRESENTATIVES.

		£
Capital at 31st December, 1940		16,000
Interest thereon—3 months @ 5% p.a.		200
		16,200
	£	
Less Drawings	697	
Add Interest 5% p.a. for 2 months on £240	2	
„ „ „ 1 month „	1	700
		15,500
Goodwill (¼)		4,500
Estimated Profits (¼ of $\frac{£14,750+£17,250}{2} \times \frac{1}{4}$)		1,000
Insurance Policy (¼)		3,000
Amount due		24,000
Add Interest @ 5% p.a. for 6 months		600
Amount paid on 30th September, 1941		£24,600

NOTES: (1) Goodwill is calculated as follows:—

		£
Profits	1939	14,750
„	1940	17,250
		2)32,000
Average profits		16,000
Less Average normal profits		10,000
Super profits		£6,000
3 years' purchase		£18,000
Pearson's share (¼)		£4,500

(2) It is assumed that no account had been opened in the books for the Survivorship Assurance Policy. Pearson's representatives are thus entitled to one-fourth of £12,000. If a Policy Account had been opened in the books, Pearson would only be credited with one-fourth of the excess of £12,000 over the book value.

Adjusting Accounts on Dissolution.

The statutory provisions of the Partnership Act, 1890, with regard to the adjustments of accounts between partners on dissolution, are as follows :—

Section 44. In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed :

(*a*) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits :

(*b*) The assets of the firm, including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order :

1. In paying the debts and liabilities of the firm to persons who are not partners therein :
2. In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital :
3. In paying to each partner rateably what is due from the firm to him in respect of capital :
4. The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible.

The above rules apply "subject to any agreement," but it should be noted that partners cannot make an agreement between themselves which will affect their liability to third parties, unless such third parties are joined in the agreement ; they can, however, make any agreement they wish as to the way in which the firm's liabilities shall be borne *inter se*, i.e., as between the partners themselves.

Book-keeping Entries on Dissolution.

The following procedure is required to record the realisation of the assets and the adjustment of the partners' accounts on a dissolution of the business :—

(1) Close all asset accounts, excepting Cash, after crediting all specific reserves thereto, by transferring the balances of such accounts, representing the book values of the assets, to the debit of a Realisation Account.

(2) Debit Cash and credit Realisation Account with the amounts realised for the assets.

(3) If a partner personally takes over part of the assets, debit that partner's capital account with the agreed

valuation of the asset or assets taken over, and credit the Realisation Account.

(4) All expenses incurred are credited to Cash and debited to Realisation Account.

(5) Credit Cash and debit the creditors' accounts as and when the liabilities are discharged.

(6) If a hitherto contingent liability matures during the winding-up of the business, credit Cash and debit Realisation Account.

(7) Discounts received from creditors and allowances made by them are credited to the Realisation Account.

(8) The balance of the Realisation Account will be the profit or loss, as the case may be, on realisation, and is divided among the partners in the proportion in which profits or losses are shared.

(9) If any partner's account then shows a debit balance, the partner concerned must introduce cash to the amount of the deficiency, the entries being a debit to Cash and a credit to the partner's Capital Account.

(10) Finally, the cash balance will exactly equal the totals standing to the credit of the partners' accounts, which are closed upon payment in the following order :—

(*a*) Partners' Loan Accounts.

(*b*) Partners' Current Accounts and Partners' Capital Accounts.

The balance of the Realisation Account may be transferred to a separate account called the " Profit and Loss on Realisation Account," which shows the appropriation between the partners. Alternatively, the balance may be brought down into a continuation of the Realisation Account, where the disposal of the profit or loss is shown, as in the following example, which illustrates the foregoing principles :—

EXAMPLE.

A. B. and *C. D.*, trading in partnership, agree to dissolve partnership on 31st December, 19.., and to liquidate the business. The Balance Sheet on that date was as follows :—

Liabilities.	£	s.	d.	*Assets.*	£	s.	d.
Capital Accounts :—				Cash . . .	1,764	10	0
A. B.	7,488	5	4	Sundry Debtors . .	3,615	4	9
C. D. . . .	510	5	0	Stock . .	4,916	8	4
Loan, *A. B.*	2,000	0	0	Plant and Fixtures .	1,421	12	11
Sundry Creditors . .	2,719	5	8	Goodwill . . .	1,000	0	0
	£12,717	16	0		£12,717	16	0

Profits and losses are shared between the two partners in the proportions three-fifths to *A. B.* and two-fifths to *C. D.*

The Sundry Debtors realised £3,204 5s., the Stock, £4,115 10s. 4d.; Plant and Fixtures, £1,716 10s. 6d.; and the Goodwill, £350.

The costs of the liquidation amounted to £47 5s. 8d.

You are required to show the process of realisation in the books of the firm, and the position of the partners as regards the disposal of the balance of cash.

Dr. REALISATION ACCOUNT. *Cr.*

		£	s.	d.			£	s.	d.
To Book Values of—					By Cash realised—				
Sundry Debtors		3,615	4	9	Sundry Debtors		3,204	5	0
Stock . .		4,916	8	4	Stock . .		4,115	10	4
Plant and Fixtures . .		1,421	12	11	Plant and Fixtures . .		1,716	10	6
Goodwill. .		1,000	0	0	Goodwill. .		350	0	0
„ Cash— Liquidation Costs		47	5	8	„ Loss on Realisation . .	*c/d.*	1,614	5	10
		£11,000	11	8			£11,000	11	8
To Balance . .	*b/d.*	1,614	5	10	By Partners' Capital Accounts—				
					A. B., $\frac{3}{5}$ths .		968	11	6
					C. D., $\frac{2}{5}$ths .		645	14	4
		£1,614	5	10			£1,614	5	10

Dr. *A. B.*, CAPITAL ACCOUNT. *Cr.*

		£	s.	d.			£	s.	d.
To Realisation A/c.— $\frac{3}{5}$ths share of loss		968	11	6	By Balance . .	*b/d.*	7,488	5	4
„ Cash . .		6,519	13	10					
		£7,488	5	4			£7,488	5	4

Dr. *A. B.*, LOAN ACCOUNT. *Cr.*

		£	s.	d.			£	s.	d.
To Cash . .		£2,000	0	0	By Balance . .	*b/d.*	2,000	0	0

Dr. *C. D.*, CAPITAL ACCOUNT. *Cr.*

		£	s.	d.			£	s.	d.
To Realisation A/c.— $\frac{2}{5}$ths share of loss		645	14	4	By Balance . .	*b/d.*	510	5	0
					„ Cash . .		135	9	4
		£645	14	4			£645	14	4

Dr. CASH ACCOUNT. *Cr.*

		£ s. d.			£ s. d.
To Balance . .	*b/d.*	1,764 10 0	By Creditors .		2,719 5 8
„ Realisation A/c.—			„ Liquidation costs		47 5 8
Debtors . .		3,204 5 0	„ Balance . .	*c/d.*	8,384 4 6
Stock . .		4,115 10 4			
Plant and Fixtures . .		1,716 10 6			
Goodwill. .		350 0 0			
		£11,150 15 10			£11,150 15 10
To Balance . .	*b/d.*	8,384 4 6	By *A. B.*, Loan A/c.		2,000 0 0
„ *C. D.*, Capital A/c.		135 9 4	„ *A. B.*, Capital A/c.		6,519 13 10
		£8,519 13 10			£8,519 13 10

In many cases, the assets are realised piecemeal over a period, and when it is desired to repay the partners' capitals as and when the cash is received, this should preferably be done in such a way as to reduce the balances on the capital accounts to the profit-sharing ratio, those capitals which are greatest in proportion to the profit-sharing ratio participating in the distribution before those which are relatively smaller. If this method were not adopted, it might result in a partner's account becoming overdrawn when his share of the loss on realisation is debited to his account, necessitating a refund by the partner in question if the assets did not realise sufficient to repay the capitals in full.

EXAMPLE.

The following is the Balance Sheet of Jones, Smith and Wilson (who share profits in the ratio 4 : 3 : 1), on 31st March, 1941, on which date they dissolve partnership.

Their capitals are to be repaid as and when the assets are realised.

BALANCE SHEET AS AT 31ST MARCH, 1941.

Liabilities.	£	*Assets.*	£
Sundry Creditors . .	2,625	Freehold Premises . .	5,000
Bank Overdraft (Unsecured) . . .	875	Machinery and Plant .	2,000
Capital Accounts—		Stock	5,500
Jones . . .	7,000	Sundry Debtors . .	6,000
Smith . . .	3,000		
Wilson . . .	5,000		
	£18,500		£18,500

The assets realised the following amounts, which were immediately distributed :—

1941	£
31st May	2,000
31st July	1,500
30th September	2,500
31st October	4,000
31st December	6,500

No further sums could be realised.

Prepare a statement showing the distribution.

NOTES: (1) The creditors and bank overdraft must be paid before the partners receive anything.

(2) The capitals of Jones and Wilson must be repaid rateably until all are in the profit-sharing ratio, when all partners will share in that proportion. The amounts to pay the respective partners may be ascertained thus :—

	Jones.	Smith.	Wilson.
	£	£	£
Capital Accounts	7,000	3,000	5,000
Capitals in profit-sharing ratio	4,000	3,000	1,000
Excess Capitals	3,000		4,000
Capitals of Jones and Wilson in profit-sharing ratio	3,000		750
Excess Capital of Wilson			£3,250

Wilson must therefore be repaid £3,250 before Jones receives anything, and Jones and Wilson must be repaid £3,000 and £750 (£4,000-£3,250) respectively in their profit-sharing ratio of 4 : 1 before Smith receives anything. Any subsequent instalments will be distributed in the profit-sharing ratio of 4 : 3 : 1.

DISTRIBUTION STATEMENT.

	Date.	Total.	Creditors.	Bank Over-draft.	Jones.	Smith.	Wilson.
	1941	£	£	£	£	£	£
	May 31	2,000	1,500	500			
	July 31	1,500	1,125	375			
	Sept. 30	2,500					2,500
	Oct. 31	4,000			2,600		750 650
	Dec. 31	6,500			400 3,000	2,250	100 750
Total payments		16,500	2,625	875	6,000	2,250	4,750
Original amounts due		18,500	2,625	875	7,000	3,000	5,000
Amount of loss		£2,000	..	..	1,000	750	250

It will thus be seen that the loss is borne in the profit-sharing ratio, without involving any further adjustment of the partners' Capital Accounts.

Conversion or Sale of a Partnership Business to a Limited Company.

The principles upon which the partnership books are closed when the business is converted into, or sold to, a limited company are similar to those illustrated on pages 605 to 607. The purchase price may be payable either wholly in cash or shares, or partly in cash and the balance in shares, as may be arranged. The shares, etc., are divided between the partners—according to agreement—in the manner illustrated in the following example :—

EXAMPLE.

A and *B* are in partnership, sharing profits and losses as to two-thirds and one-third respectively. Their Balance Sheet at 30th September, 19.., on which date they have agreed to convert their business into a limited company, is as follows :—

A and *B*

BALANCE SHEET, 30TH SEPTEMBER, 19..

Liabilities.	£	£	*Assets.*	£	£
Sundry Creditors .		15,000	Cash at Bank and in hand . . .		3,500
Mortgage on Freehold Premises . .		5,000	Sundry Debtors .	14,000	
Capital—			*Less* Reserve .	1,000	
A	7,500				13,000
B	7,500		Stock . . .		8,000
		15,000	Plant and Fixtures .		2,500
			Freehold Premises .		8,000
		£35,000			£35,000

The company takes over all the assets and liabilities except the mortgage, the purchase price being £30,000, payable in cash £12,000, in Debentures £6,000, and in fully-paid Ordinary Shares of £1 each, £12,000. The firm have to discharge the formation expenses, amounting to £240.

You are required to close *A* and *B's* books after these transactions have been carried out, including the discharge of the mortgage, the partners sharing the Debentures, Shares, etc., in proportion to their capitals.

Dr. REALISATION ACCOUNT. Cr.

		£	s.	d.			£	s.	d.
To Sundry Assets as per Balance Sheet . .		35,000	0	0	By Liabilities taken over . .		15,000	0	0
„ Formation Expenses . .		240	0	0	„ New Company .		30,000	0	0
„ Balance, being Profit on Realisation .	c/d.	9,760	0	0					
		£45,000	0	0			£45,000	0	0
To Capital A/c.'s—					By Balance . .	b/d.	9,760	0	0
A, two-thirds .		6,506	13	4					
B, one-third .		3,253	6	8					
		£9,760	0	0			£9,760	0	0

Dr *A*, CAPITAL ACCOUNT. Cr.

		£	s.	d.			£	s.	d.
To Cash . .		5,006	13	4	By Balance . .	b/d.	7,500	0	0
„ Debentures .		3,000	0	0	„ Realisation A/c.		6,506	13	4
„ Shares . .		6,000	0	0					
		£14,006	13	4			£14,006	13	4

Dr. *B*, CAPITAL ACCOUNT. Cr.

		£	s.	d.			£	s.	d.
To Cash . .		1.753	6	8	By Balance . .	b/d.	7,500	0	0
„ Debentures .		3,000	0	0	„ Realisation A/c.		3,253	6	8
„ Shares . .		6,000	0	0					
		£10,753	6	8			£10,753	6	8

Dr. MORTGAGE ACCOUNT. Cr.

		£	s.	d.			£	s.	d.
To Cash . .		5,000	0	0	By Balance . .	b/d.	5,000	0	0

Dr. NEW COMPANY. Cr.

		£	s.	d.			£	s.	d.
To Realisation A/c..		30,000	0	0	By Cash . .		12,000	0	0
					„ Debentures .		6,000	0	0
					„ Ordinary Shares		12,000	0	0
		£30,000	0	0			£30,000	0	0

Dr. DEBENTURES IN NEW COMPANY. Cr.

		£ s. d.			£ s. d.
To New Company .		6,000 0 0	By *A* . . .		3,000 0 0
			„ *B* . . .		3,000 0 0
		£6,000 0 0			£6,000 0 0

Dr. ORDINARY SHARES IN NEW COMPANY. Cr.

		£ s. d.			£ s. d.
To New Company .		12,000 0 0	By *A* . . .		6,000 0 0
			„ *B* . . .		6,000 0 0
		£12,000 0 0			£12,000 0 0

Dr. CASH BOOK. Cr.

		£ s. d.			£ s. d.
To New Company .		12,000 0 0	By Repayment of Mortgage .		5,000 0 0
			„ Realisation A/c.: Formation Expenses . .		240 0 0
			„ Balance . .	*c/d.*	6,760 0 0
		£12,000 0 0			£12,000 0 0
To Balance . .	*b/d.*	6,760 0 0	By *A* . . .		5,006 13 4
			„ *B* . . .		1,753 6 8
		£6,760 0 0			£6,760 0 0

In some cases the purchasing company does not take over all the assets, some being retained by the vendors, and debited to their Capital Accounts in closing off the books. The purchasing company may agree, for a commission, to collect the debts due to the vendor, and to pay the creditors out of the moneys collected. The debtors and creditors must not be transferred to Realisation Account (since they are not taken over by the purchasers), but can be transferred to a "Collection Account" in the name of the purchasers, cash being credited thereto when it is received from the debtors or debited thereto when it is paid to the creditors.

EXAMPLE.

Y and Z shared profits and losses equally, and on 31st December, 1940, sold their business to X. Y. Z., Ltd., which agreed to take over, on the basis of the values shown in the firm's Balance Sheet at that date, all the assets of the firm except debtors, which the company was to collect on the firm's behalf for a commission of 5 per cent. Out of the amounts collected, the company was to pay the creditors of the firm, which were not taken over. The following was the Balance Sheet of Y and Z at the date of the sale :—

BALANCE SHEET AS AT 31ST DECEMBER 1940.

Liabilities.	£	*Assets.*	£	£
Sundry Creditors	2,750	Sundry Assets		12,000
Capital Accounts :—		Sundry Debtors	5,500	
Y	7,250	*Less* Bad Debts Reserve	250	
Z	7,250			5,250
	£17,250			£17,250

The purchase consideration was £15,000, payable as to £10,000 in £1 Ordinary Shares and the balance in 5% Debentures.

Show the Journal entries necessary to record the above in the books of the Firm and the Company, assuming that the creditors were paid in full on 31st March, 1941, that £3,000 had been collected from debtors to this date, the balance (after deduction of commission) being paid to the vendors. The remaining debts realised £1,900, which was paid to the vendors (less commission) on 30th June, 1941.

Y AND Z JOURNAL.

		£	£
1940			
Dec. 31	Realisation Account . . . . *Dr.*	12,000	
	To Sundry Assets		12,000
	Being sale of assets to X. Y. Z., Ltd.		
,, ,,	X. Y. Z., Ltd. . . . . . *Dr.*	15,000	
	To Realisation Account		15,000
	Being purchase consideration for assets sold to X. Y. Z., Ltd.		
,, ,,	Realisation Account . . . . *Dr.*	3,000	
	To Y, Capital Account		1,500
	,, Z, ,,		1,500
	Being profit on realisation transferred to capital accounts.		
,, ,,	Ordinary Shares in X. Y. Z., Ltd. . *Dr.*	10,000	
	Debentures in X. Y. Z., Ltd. . . *Dr.*	5,000	
	To X. Y. Z., Ltd.		15,000
	Being discharge of purchase consideration by the issue of 10,000 Ordinary Shares of £1 each and £5,000, 5% Debentures.		
,, ,,	Sundry Creditors . . . . *Dr.*	2,750	
	To X. Y. Z., Ltd., Collection Account		2,750
	Being transfer of creditors to be paid by purchasers out of moneys collected from debtors.		
,, ,,	X. Y. Z., Ltd., Collection Account . *Dr.*	5,500	
	Bad Debts Reserve . . . . *Dr.*	250	
	To Sundry Debtors		5,500
	,, X.Y. Z., Ltd., Collection Account		250
	Being transfer of debtors to be collected by purchasers.		

Y AND Z JOURNAL—*continued.*

		£	s.	£
1941 Mar. 31	Cash . . . . *Dr.*	100		
	Commission Account . . . *Dr.*	150		
	To X. Y. Z., Ltd., Collection Account .			250
	Being cash received from X. Y. Z., Ltd., for debts collected, less disbursements :— £ *Cash from Debtors* . 3,000 Less *Commission* £ *@ 5 per cent.* . 150 *Creditors paid* . 2,750 ——— 2,900 *Cash remitted* . . . £100			
June 30	Cash . . . . *Dr.*	1,805		
	Commission Account . . . *Dr.*	95		
	To X. Y. Z., Ltd., Collection Account .			1,900
	Being cash collected from debtors, less 5 % commission.			
" "	Y, Capital Account . . . *Dr.*	297	10	
	Z, " " . . . . *Dr.*	297	10	
	To X. Y. Z., Collection Account . .			350
	" Commission Account . . .			245
	Being commission and loss on debtors transferred to Capital Accounts.			
" "	Y, Capital Account . . . *Dr.*	8,452	10	
	Z, " " . . . . *Dr.*	8,452	10	
	To Ordinary Shares in X. Y. Z., Ltd. .			10,000
	" Debentures in X. Y. Z., Ltd.. .			5,000
	" Cash			1,905
	Being distribution of Shares, Debentures and Cash.			

NOTE.—As X and Y share profits and capital equally, the shares and debentures in X. Y. Z., Ltd., and the balance of cash (£1,905), will be divided equally between the partners.

X. Y. Z., LTD., JOURNAL.

		£	£
1940 Dec. 31	Sundry Assets . . . . *Dr.*	12,000	
	Goodwill Account . . . . *Dr.*	3,000	
	To Y and Z		15,000
	Being assets acquired from Y and Z.		
" "	Y and Z . . . . *Dr.*	15,000	
	To Ordinary Share Capital Account .		10,000
	" 5% Debentures Account . .		5,000
	Being 10,000 £1 *Ordinary Shares and* £5,000 5% *Debentures issued in payment of the above assets.*		

X. Y. Z., LTD., JOURNAL—*continued.*

		£	£
1941 Mar. 31	Cash . . . . *Dr.*	3,000	
	To Y and Z (Collection Account) . .		3,000
	Being cash collected from debtors of Y and Z.		
„ „	Y and Z (Collection Account) . . *Dr.*	3,000	
	To Cash		2,850
	„ Commission Account . . .		150
	Being payment of Y and Z's creditors and of the balance due to Y and Z less 5% commission on debts collected.		
June 30	Cash . . . . *Dr.*	1,900	
	To Y and Z (Collection Account) . .		1,900
	Being cash collected from Y and Z's debtors.		
„ „	Y and Z (Collection Account) . . *Dr.*	1,900	
	To Cash		1,805
	„ Commission Account . . .		95
	Being cash collected from debtors paid to Y and Z less 5% commission.		

THE RULE IN GARNER v. MURRAY

This rule applies on the dissolution of a partnership, when the capital account of a partner shows a debit balance after his share of any profit or loss on realisation has been included in his account, and he cannot make good the whole or part of the deficiency. It was decided in the case of *Garner* v. *Murray*, 1904, that in such circumstances, and in the absence of any agreement to the contrary, this deficiency must be shared by the remaining partners *in proportion to their last agreed capitals* and *not* in the proportion in which they share profits and losses.

The effect of this decision is to distinguish between a loss due to trading or realisation, and one due to the inability of a partner to make good a debit balance on his account. The loss caused by the default of a partner must be borne *by the remaining partners* in proportion to their last agreed capitals, whereas a loss on trading or realisation must be borne *by all the partners* (i.e., *including* the insolvent partner) in the proportions in which they share profits and losses. If the capital accounts of the solvent partners have remained fixed throughout the existence of the partnership, the original capitals of the solvent partners will be used as the basis for the division of the insolvent partner's deficiency, but if the original capitals have been varied periodically by express or implied agreement the capital balances shown to

the credit of the solvent partners at the end of the last accounting period before dissolution will be utilised as the basis. It is contended by the leading authorities that current account balances should be ignored in this connection.

In theory, the solvent partners should pay cash into the firm in respect of their shares of the loss on realisation, but as this merely increases the amount due to them it is usually omitted in practice, the net amount due to the partners being repaid.

EXAMPLE.

A, *B*, and *C*, equal partners, dissolved partnership on the 31st December, when their Balance Sheet showed the following position :—

BALANCE SHEET.

Liabilities.	£	*Assets.*	£
Sundry Creditors	1,000	Land and Buildings	1,000
A—Loan	500	Plant and Machinery	800
Partners' Capitals—		Stock	1,050
A	2,200	Sundry Debtors	2,100
B	1,800	Cash at Bank	350
		Capital A/c—*C*	200
	£5,500		£5,500

The Assets realised the following amounts :—

	£
(*a*) Book Debts	2,000
(*b*) Stock	750
(*c*) Plant and Machinery	650
(*d*) Land and Buildings	1,100

The costs of realisation amounted to £150, and the creditors were discharged, less $2\frac{1}{2}\%$ discount. *C* was unable to contribute anything towards his ultimate deficiency.

Give the entries necessary to close the books of the firm.

Dr. REALISATION ACCOUNT. *Cr.*

		£	s.	d.			£	s.	d.
To Sundry Assets		4,950	0	0	By Cash (Realisation of Assets)		4,500	0	0
„ Costs of Realisation		150	0	0	„ Discounts on Liabilities		25	0	0
					„ Balance, being Loss on Realisation	*c/d.*	575	0	0
		£5,100	0	0			£5,100	0	0
To Balance	*b/d.*	575	0	0	By Transfer to Capital Accounts—				
					A, one-third		191	13	4
					B, one-third		191	13	4
					C, one-third		191	13	4
		£575	0	0			£575	0	0

Dr. CAPITAL ACCOUNTS. *Cr.*

		A	*B*	*C*			*A*	*B*	*C*
		£ s. d.	£ s. d.	£ s. d.			£ s. d.	£ s. d.	£ s. d.
To Balance . .	*b/d.*			200 0 0	By Balances . .	*b/d.*	2,200 0 0	1,800 0 0	
„ Realisation Account—loss .		191 13 4	191 13 4	191 13 4	„ Transfer of Deficiency .				391 13 4
„ Transfer of *C's* Deficiency :—									
A—$\frac{22}{40}$ . .		215 8 4							
B—$\frac{18}{40}$ . .			176 5 0						
„ Cash . .		1,792 18 4	1,432 1 8						
		£2,200 0 0	£1,800 0 0	£391 13 4			£2,200 0 0	£1,800 0 0	£391 13 4

Dr. CASH BOOK. *Cr.*

		£ s. d.			£ s. d.
To Balance . .	*b/d.*	350 0 0	By Sundry Creditors		975 0 0
„ Sundry Assets .		4,500 0 0	„ Costs of Realisation . .		150 0 0
			„ *A*—Loan repaid		500 0 0
			„ Balance . .	*c/d.*	3,225 0 0
		£4,850 0 0			£4,850 0 0
To Balance . .	*b/d.*	3,225 0 0	By *A*, Capital A/c. .		1,792 18 4
			„ *B*, Capital A/c. .		1,432 1 8
		£3,225 0 0			£3,225 0 0

The capital ratio in *Garner* v. *Murray* refers to the credit balances on partners' accounts, thus if a solvent partner's account is in debit (before charging him with his share of the loss on realisation) he will not be required to contribute towards the deficiency of an insolvent partner, but he will be liable to make good the final amount to the debit of his own account.

Elliott v. Elliott.

The rule in the case of *Elliott* v. *Elliott*, 1911 (see page 209), may be reconsidered at this point. It should be noted that the decision will only apply in the absence of agreement to the contrary, and where the remaining partners agree to *buy* the share of the retired or deceased partner, and not to pay for the share immediately, since in the latter case the question of any amount owing to the retired or deceased partner cannot arise.

BANKRUPTCY

Traders and persons who are unable to meet their liabilities are said to be "insolvent," but before such persons can be made "bankrupt" they must have committed an "Act of Bankruptcy." This is an act or default on the part of a debtor which is deemed to be evidence of his insolvency. The various acts of bankruptcy are given in Section 1 of the Bankruptcy Act, 1914, and arise if a debtor does any of the following :—

(1) Makes a conveyance or assignment of his property to a trustee for the benefit of his creditors generally ;

(2) Makes a fraudulent conveyance, gift, delivery, or transfer of his property or any part thereof ;

(3) Makes any conveyance or transfer of his property or any part thereof, or creates any charge thereon which would be void as a fraudulent preference if he were adjudged bankrupt ;

(4) Departs out of England, or being out, remains out, or departs from his dwelling-house, absents himself, or begins to keep house with intent to defeat or delay his creditors ;

(5) Permits execution to be levied against him, and allows the goods to be sold or held by the Sheriff for twenty-one days ;

(6) Files a declaration of his inability to pay his debts, or files a petition against himself ;

(7) Fails to comply with a bankruptcy notice served upon him ;

(8) Gives notice to any of his creditors that he has suspended, or is about to suspend, payment of his debts.

A petition in Bankruptcy, praying that the debtor be adjudged bankrupt, must be presented to the Court having jurisdiction, within three months after the date of the act of bankruptcy which forms the basis of the petition, but a creditor or creditors cannot petition unless the amount of the debt owing to him or them exceeds £50.

After the petition has been heard by the Court and the facts have been proved to its satisfaction, the Court makes a Receiving Order against the debtor, under which the Official Receiver takes over all the debtor's property; all legal proceedings against the debtor or his property are automatically stayed.

The debtor is required to file with the Official Receiver a "Statement of Affairs" in the prescribed form, and the Official Receiver then convenes a meeting of the creditors to decide—

(*a*) Whether the debtor shall be adjudicated bankrupt ; or

(*b*) Whether any proposal which may be made by the debtor for the settlement of his indebtedness or the payment of a composition shall be accepted.

In the latter case, the proposal must be submitted to the Court for approval, and if it is sanctioned, the Receiving Order is annulled. Where the debtor is adjudicated bankrupt, his property is administered by a "Trustee in Bankruptcy." Usually, the Official Receiver is appointed "trustee" in the first instance, but, subject to the approval of the Court, the creditors may appoint some other person. A "Committee of Inspection" is customarily appointed by the creditors to supervise the realisation and distribution of the debtor's property by the trustee.

The object of the bankruptcy procedure is twofold—

(1) To divide the debtor's property fairly and equitably amongst his creditors ; and

(2) To relieve the debtor from the excess of his liabilities over his assets.

After adjudication as a bankrupt, the debtor must attend a public examination before the Court and answer such questions as are put to him as to his affairs and the causes of his failure. After his property has been realised and distributed amongst his creditors, the debtor may apply for his "Discharge," which releases him from further liability for past debts (with a few exceptions), and enables him to make a fresh start. The Court may grant the discharge immediately or subject to certain conditions, or suspend it for a period, or refuse it altogether. Suspension or refusal occur only when the debtor has been guilty of certain offences. It is provided by Section 7 of the Bankruptcy (Amendment) Act, 1926, that any person who is adjudicated bankrupt shall be guilty of a misdemeanour and be liable to imprisonment if, having been engaged in trade or business during the two preceding years, he has failed to keep and preserve proper books of account throughout such period of two years. No liability will be incurred where, in the case of a first bankruptcy, the unsecured liabilities do not exceed £500 ; or in a second bankruptcy the liabilities do not exceed £100 ; or in any case when the omission is honest and excusable.

For the purposes of the above section, the term "proper books of account" is defined as "such books and accounts as are necessary to exhibit or explain his transactions and financial position in his trade or business, including a book or books containing entries from day to day in sufficient detail of all cash received and cash paid, and, where the trade or business has involved dealings in goods, statements of annual stocktakings, and (except in the case of goods sold by way of retail trade to the actual consumer) accounts of all goods sold and purchased showing the buyers and sellers thereof in sufficient detail to enable the goods and the buyers and sellers thereof to be identified."

Statement of Affairs.

This statement—which must be in the prescribed form—contains a summary of the debtor's total liabilities and assets. The various classes of creditors are differentiated : unsecured, secured, partly secured, and preferential creditors are shown separately, whilst the assets are shown at their estimated realisable values. This statement is supported by Schedules marked A to J successively, containing detailed lists of the different classes of creditors and of the debtor's property. A Deficiency Account (K) is also attached showing on the left-hand side the excess (if any) of the debtor's assets over his liabilities at a given date, and particulars of his trading profits and other income during the intervening period, and showing on the credit side the excess (if any) of the debtor's liabilities over his assets at the given date

and the amount of his drawings, trading losses and estimated losses on realisation of his assets. The balance of the Deficiency Account—surplus or deficiency, as the case may be—must agree with the balance of the Statement of Affairs.

A deficiency of assets appears on the right-hand side of the Statement of Affairs and on the left-hand side of the Deficiency Account, whereas a surplus of assets appears in the converse manner.

The Statement of Affairs shows the estimated financial position of the debtor while the Deficiency Account explains how he has arrived in that position.

If necessary, the debtor may obtain professional assistance in the compilation of the Statement of Affairs and the Deficiency Account.

Preferential Creditors.

A landlord is entitled to distrain, i.e., seize the property of his debtor for rent owing, either before or after the commencement of the bankruptcy; but if he distrains after the commencement, he may retain only six months' rent accrued prior to the adjudication of the debtor. If the landlord distrains more than three months prior to the date of the Receiving Order, the distress is good for the whole amount due; but where he distrains within three months prior to the date of the Receiving Order, the claims of the preferential creditors must be met out of the proceeds of the realisation of the debtor's property. In the latter case, however, the landlord is entitled to stand in the place of the persons to whom payment has been made; i.e., he is "subrogated" to their rights.

The following are preferential payments which all rank equally between themselves :—

(1) Rates due and payable within the twelve months prior to the date of the Receiving Order, and all assessed taxes, land tax, property or income tax assessed up to 5th April prior to the date of the Receiving Order, but not exceeding one year's assessment.

(2) Wages or salaries of clerks or servants for services rendered during the preceding four months, not exceeding £50. The Bankruptcy (Amendment) Act, 1926, definitely declares that this priority shall apply to wages, etc., earned wholly or in part by way of commission.

(3) Wages of workmen for not more than two months, not exceeding £25.

(4) Compensation due to an employee under the Workmen's Compensation Acts.

(5) Employer's contributions under the National Health Insurance Acts, 1911 to 1921, and Unemployment Insurance Act, 1921.

The statutory provisions governing preferential payments are contained in Sections 33-35 of the Bankruptcy Act, 1914.

Deferred Creditors.

Certain classes of creditors are, by statute, unable to recover anything from the bankrupt's estate until the whole of the unsecured creditors have been paid in full. These classes include :—

(1) Creditors who have advanced money to a bankrupt or insolvent debtor in return for a rate of interest varying with the profits. (Section 3 of the Partnership Act, 1890.)

(2) The vendor of the goodwill of a business who is to receive as consideration a share in the profits of the business. (Section 3 of the Partnership Act, 1890.)

(3) A wife who has advanced money to her husband for use in his business or trade, and, similarly, debts owing to a husband who has advanced money to his wife for use in her separate business or trade. (Section 36 of the Bankruptcy Act, 1914).

EXAMPLE.

Albert Trustall commenced business on 1st January, 1936, with a Capital of £33,600. His profits for the years 1936 to 1940 were £4,000, £3,200, £1,800, £1,400, and £400, respectively; and his drawings averaged £2,200 per annum.

On 31st December, 1940, a Receiving Order was made against him, when his affairs were as follows :—

	£
Unsecured Creditors	20,000
Mortgage on Freehold Factory	4,000
Creditors partly secured	12,000
(Security, Life Policies estimated to be worth £4.000.)	
Creditors for Salaries and Wages (Preferential)	480
Bills Receivable, discounted and expected to rank	3,200
Freehold Factory, cost £40,000; estimated to realise	20,000
Plant and Machinery, cost £8,000; estimated to realise	2,000
Book Debts, good, £6,000; doubtful, £2,000, estimated to realise £600; bad, £5,000	
Fixtures and Fittings, cost £800; estimated to realise	350
Stock-in-Trade, cost £8,000; estimated to realise	5,550
Cash in hand	80

From the above particulars prepare Statement of Affairs and Deficiency Account in statutory form.

THE BANKRUPTCY ACT, 1914.

STATEMENT OF AFFAIRS.

(a) High Court of Justice or the County Court of——, holden at——.

In the (a) *High* Court of *Justice*

In Bankruptcy No. *851* of *1940*

Re Albert Trustall

To THE DEBTOR.—You are required to fill up, carefully and accurately, this Sheet, and such of the several Sheets A, B, C, D, E, F, G, H, I, J, and K, (1) as are applicable showing the state of your affairs on the day on which the Receiving Order was made against you, viz., the *31st* day of *December*, 19*40*.

Such Sheets, when filled up, will constitute your Statement of Affairs, and must be verified by Oath or Declaration

Gross Liabilities.	LIABILITIES (as stated and estimated by Debtor).		Expected to Rank.
£			£
20,000	Unsecured Creditors, as per list (A) ..		*20,000*
		£	
4,000	Creditors fully secured, as per list (B)..	*4,000*	
	Estimated value of securities ..	*20,000*	
	Surplus	*16,000*	
	Less amount thereof carried to Sheet C		
	Balance thereof to contra ..	*16,000*	
		£	
12,000	Creditors partly secured, as per list (C)	*12,000*	
	Less estimated value of securities	*4,000*	
			8,000
	Liabilities on bills discounted other than debtor's own acceptances for value, as per list (D), viz.:—		
	On accommodation bills, as drawer, acceptor, or indorser	£	
3,200	On other bills, as drawer or indorser	*£3,200*	
		£3,200	
	Of which it is expected will rank against the estate for dividend ..		*3,200*
	Contingent or other liabilities as per list (E)	£	
	Of which it is expected will rank against the estate for dividend..		*nil*
	Creditors for rent, &c., recoverable by distress as per list (F)	£	
480	Creditors for rates, taxes, wages, &c., payable in full, as per list (G)	*480*	
	Sheriff's charges payable under sec. 41 of the Act, estimated at		
	Deducted contra .. .. £	*480*	
	(2) Surplus explained in statement (K)..		
£39,680		£	*31,200*

ASSETS (as stated and estimated by Debtor).		Estimated to Produce.
		£
Property, as per list (H), viz.:—		
(a) Cash at Bankers		
(b) Cash in hand		*80*
(c) Cash deposited with Solicitor for costs of Petition		
(d) Stock in Trade (cost *£8,000*) ..		*5,550*
(e) Machinery (*book value*, *£8,000*) ..		*2,000*
(f) Trade fixtures, fittings, utensils, &c. (*book value*, *£800*)		*350*
(g) Farming stock		
(h) Growing crops and tenant right ..		
(i) Furniture		
(j) Life Policies..		
(k) Stocks and Shares		
(l) Reversionary or other interests under Wills		
(m) Other property, viz.:—		
Total as per list (H) ..		*7,980*
Book debts, as per list (I), viz.:—		
Good		*6,000*
	£	
Doubtful	*2,000*	
Bad	*5,000*	
£	*7,000*	
Estimated to produce		*600*
Bills of Exchange or other similar securities, on hand, as per list (J) .. .. £		
Estimated to produce		
Surplus from securities in the hands of creditors fully secured (per contra) (*Freehold Factory*)		*16,000*
		30,580
Deduct creditors for distrainable rent, and for preferential rates, taxes, wages, Sheriff's charges, etc. (per contra) ..		*480*
		£ *30,100*
(2) Deficiency explained in statement (K)		*1,100*
		£ *31,200*

(1) Sheet "L" should be substituted for any one or more of the sheets named as will have to be returned blank.
(2) Strike out which words do not apply.

K

DEFICIENCY (OR SURPLUS) ACCOUNT.

	£	£		£	£
Excess of assets over liabilities on the (1) *First* day of *January* 1936 (if any) ..		33,600	Excess of liabilities over assets on the (1) day of 19 (if any)		
Net profit (if any) arising from carrying on business from the (1) *First* day of *January* 1936, to date of Receiving Order, after deducting usual trade expenses. *For the year* 1936	4,000		Net loss (if any) arising from carrying on business from the (1) day of 19 to date of Receiving Order, after charging against profits the usual trade expenses		
1937	3,200		Bad debts (if any) as per Schedule " I " (2)		6,400
1938	1,800		Depreciation of Stock-in-Trade		2,450
1939	1,400		Depreciation of Machinery *and Plant* ..		6,000
1940	400	10,800	Depreciation of Trade Fixtures, Fittings, &c.		450
Income or profit from other sources (if any) since the (1) day of 19			*Depreciation of Freehold Factory*		20,000
Gifts from Relations and others			Expenses incurred since the (1) *First* day of *January* 1936, other than usual trade expenses, viz., household and personal expenses of self and (3) *two children* ..		11,000
Private Life Policies brought in		4,000	(4) Other losses and expenses (if any) ..		
(5) Deficiency as per statement of affairs ..		1,100	*Estimated loss on Bills Receivable discounted*		3,200
			(5) Surplus as per statement of affairs ..		
Total amount to be accounted for ..	(6) £	49,500	Total amount accounted for	(6) £	49,500

Signature *Albert Trustall*,
Dated *14th January*, 1941.

NOTES.—(1) This date should be 12 months before date of Receiving Order, or such other time as Official Receiver may have fixed.
(2) This Schedule must show when debts were contracted.
(3) Add " wife and children " (if any), stating number of latter.
(4) Here add particulars of other losses or expenses (if any), including liabilities (if any), for which no consideration received.
( ) Strike out words which do not apply.
(6) These figures should agree.

It will be observed in note (1) above, that the excess of assets over liabilities (or *vice versa*) shown in the Deficiency Account should be on a date twelve months prior to the date of the Receiving Order, or such other time as may be fixed by the Official Receiver. In working the above example it has been assumed that the Official Receiver fixed 1st January, 1936, as the appropriate date. If this were not the case, the Deficiency Account (in skeleton form) would appear as follows :—

DEFICIENCY ACCOUNT.

	£		£
Excess of Assets over Liabilities on 1st January, 1940	35,200	Bad Debts	6,400
Net Profit for the Year to date of the Receiving Order	400	Depreciation :—	
Life Policies	4,000	Stock	2,450
Deficiency *per* Statement of Affairs .	1,100	Machinery and Plant . . .	6,000
		Fixtures and Fittings . . .	450
		Freehold Factory	20,000
		Drawings for the Year to date of the Receiving Order	2,200
		Loss on Bills Discounted . . .	3,200
	£40,700		£40,700

The excess of assets over liabilities on 1st January, 1940, is ascertained as follows:—

	£
Capital on 1st January, 1936	33,600
Add Profits for four years to 31st December, 1940 . .	10,400
	44,000
Less Drawings for four years @ £2,200 per annum . .	8,800
Capital on 1st January, 1940	£35,200

When answering examination questions requiring the preparation of a Statement of Affairs, an abbreviation of the official form may be adopted. For example, the Statement of Affairs on page 622 would be presented in the following form.

ALBERT TRUSTALL. *31st December*, 1940.

STATEMENT OF AFFAIRS.

Gross Liabilities.	Liabilities.	Expected to Rank.	Assets.	Estimated to Produce.
£		£		£
20,000	Unsecured Creditors .	20,000	Sundry Assets—	
	£		Cash at Bank . .	
	Fully Secured		Cash in Hand . .	80
4,000	Creditors . 4,000		Stock in Trade (£8,000)	5,550
	Less Security . 20,000		Plant and Machinery (£8,000) . .	2,000
	Surplus contra £16,000		Fixtures and Fittings (£800) . . .	350
	Partly Secured			
12,000	Creditors . 12,000			7,980
	Less Security . 4,000		Book Debts— £	
		8,000	Good . .	6,000
	Liabilities on Bills Receivable Discounted .		Doubtful . 2,000	
3,200		3,200	Bad . . 5,000	
	Other Contingent Liabilities . . .		£7,000	
	Creditors for Rent .		Bills of Exchange .	600
	Preferential Creditors . . £480			
480				14,580
			Surplus from Fully Secured Creditors .	16,000
				30,580
			Deduct Preferential Creditors . .	480
				30,100
			Deficiency . . .	1,100
£39,680		£31,200		£31,200

Similarly, the Deficiency Account may be presented, for examination purposes, in a similar form to that shown at the foot of page 623.

The Duties of the Trustee in Bankruptcy.

After the trustee has been appointed, his duty is to realise the debtor's assets and to apply them in satisfaction of the debtor's liabilities in the following order :—

(1) Court Fees and expenses.

(2) Maintenance allowance (if any) to the debtor.

(3) Trustee's expenses and remuneration.

(4) Preferential creditors.

(5) Unsecured creditors.

(6) Deferred creditors.

(7) Surplus (if any) to the debtor.

Secured creditors, of course, are paid out of the moneys realised from their securities. Partly-secured creditors rank as unsecured creditors for that portion of the debt in excess of the value of the security.

The books to be kept by a trustee include :—

(1) A Record Book, giving a record of the proceedings throughout the bankruptcy.

(2) A Cash Book, showing all receipts and payments.

(3) A Trading Account, where a business is carried on, showing a distinct account of the trading.

The Trading Account and Cash Book must be audited periodically by the committee of inspection and the Board o Trade.

When the realisation and distribution of the debtor's assets are completed, a Realisation Account in the prescribed form is sent to all the creditors. The trustee's remuneration, as fixed by the creditors or the committee, usually takes the form of a percentage on the assets realised after deducting any sums paid to secured creditors out of the proceeds of their securities and a further percentage on the assets distributed to the unsecured creditors. Cash in hand or at bank would not be included in the total amount realised for the purpose of this calculation. The trustee is then entitled to apply to the Board of Trade for his release, which discharges him from further responsibility in connection with the debtor's estate.

A specimen of a trustee's Summary of Receipts and Payments is shown on page 626.

THE BANKRUPTCY ACT, 1914

In the *High* Court of *Justice*

In Bankruptcy No. *851* of *1940.*

Re *Albert Trustall*

Dr. TRUSTEE'S FINAL SUMMARY OF RECEIPTS AND PAYMENTS. *Cr.*

	Estimated to produce per Debtor's Statement.	RECEIPTS.
	£	£ s. d.
To Total Receipts from date of Receiving Order, viz. :—		
Cash transferred by debtor .	80	80 0 0
Stock-in-Trade .	5,550	5,800 0 0
Machinery .	2,000	2,500 0 0
Trade Fixtures .	350	320 0 0
Book Debts .	6,600	6,800 0 0
Freehold Factory surplus from secured creditors	16,000	16,000 0 0
Receipts per Trading A/c. .		
Other receipts .		
Total. . .	£30,580	31,500 0 0
Less :	£	
Deposit returned to Petitioner .		
Payments to redeem securities		
Cost of execution		
Payments per Trading A/c. .		
Net Realisations . . .		31,500 0 0
		£31,500 0 0

		PAYMENTS.
		£ s. d.
By Board of Trade and Court Fees, including stamp of £5 on petition		11 0 0
	£	
Law costs of petition .	11	
Other law costs . .	56	67 0 0
Trustees' Remuneration as fixed by the Court, viz. :—		
	£ s. d.	
2% on £31,420 assets realised . .	628 8 0	
1% on £29,500 assets distributed in dividend . .	295 0 0	923 8 0
Special manager's charges . .		
Person appointed to assist debtor under sec. 74		
Auctioneer's charges as taxed .		
Other taxed costs . . .		
Costs of possession . . .		
Costs of notices in Gazette . .		4 8 0
Incidental Outlay . . .		6 4 0
Total cost of realisation . .		1,012 0 0
Allowance to debtor . .		508 0 0
	£	
Creditors . .		
Preferential . .	480	
Unsecured—		
Dividend now declared of 9s. 8d. in the £ on £30,000	14,500	
Dividends previously declared @ 10s. in £ .	15,000	
N.B.—The debtors' estimate of amount expected to rank for dividend was £31,200 . . .		29,980 0 0
Balance		
		£31,500 0 0

DEEDS OF ARRANGEMENT

Insolvent traders sometimes endeavour to make private arrangements with their creditors, and, usually, such arrangements are formally expressed in a Trust Deed under which the debtor's property is transferred to a trustee to be held and managed for the benefit of his creditors. As a general rule, the trustee appointed is a professional accountant, and the principal creditors, the trustee, and the debtor are parties to the deed. Creditors who do not sign the deed may give a written assent to its provisions.

The main reason for such an arrangement is to avoid the expense, publicity, and other disadvantages of bankruptcy proceedings. The Administration of Justice Act, 1925, provides that, to be effective, the deed must be registered with the Registrar appointed by the Board of Trade for the purpose, within seven days of its execution, and be signed or assented to by a majority in number and value of the creditors, within twenty-one days of registration.

Only those creditors who assent to the deed are bound by it, and, as such a deed is an "Act of Bankruptcy," any creditor who has not assented to the Deed and whose debt exceeds £50 may present a petition in bankruptcy against the debtor. If a Receiving Order is subsequently made, the deed becomes void, and the trustee under the deed must hand over to the trustee in bankruptcy all moneys, etc., received on account of the debtor's estate.

The usual practice when a Deed of Arrangement is to be drawn up is to prepare a Statement of Affairs showing the debtor's position, on similar lines to a Statement of Affairs in Bankruptcy, and to submit it, with an outline of the proposed composition scheme, to the principal creditors. Negotiations may then ensue, and the scheme may be modified to meet the creditors' views. Subsequently, a private meeting of all the creditors is convened, and the scheme is submitted for their approval, after which the Trust Deed is executed and the trustee takes charge of the debtor's assets.

More generally, deeds of arrangement are entered into when there is some prospect of successfully re-establishing the business on a sounder basis, and, in some cases, a committee of the principal creditors supervises the management of the business until the composition scheme outlined in the deed has been completed. Moreover, private schemes of this nature often result in larger distributions to the creditors than would be made in bankruptcy, and, even where the business is to be wholly discontinued, it is sometimes more advantageous to wind up the estate privately than to initiate bankruptcy proceedings, as relatives and friends may be induced to assist the

debtor (or to forgo their own claims against him), in order that the stigma of bankruptcy shall not attach to him.

The following example illustrates the adjustments required in the books of a partnership, consequent upon the adoption and completion of a scheme of arrangement.

EXAMPLE.

X, *Y*, and *Z* are in partnership, and share profits and losses equally. On 31st March, having suffered losses, they called their creditors together and offered them 10s. in the £, which was accepted. The following is the Statement presented to the meeting:—

Liabilities.	£	*Assets.*	£	£
Sundry Creditors:—		Cash in hand		20
On Open Accounts	6,000	Sundry Debtors—		
On Bills of Exchange	3,000	(unassigned)	3,000	
The O. P. Q. Bank, Ltd.	1,000	Do. (assigned)	600	
Creditors (secured by assignment of two book debts of £350 and £250)	500			3,600
		Stock-in-Trade		3,380
		Furniture, Fixtures, etc.		200
		Machinery and Plant		1,800
		Capital Accounts overdrawn—		
		X	800	
		Y	500	
		Z	200	
				1,500
	£10,500			£10,500

The partners had no other property. The assets realised:—Sundry Debtors (unassigned), £2,600; Book Debts (assigned), £570; Stock, £2,900; Furniture, Fixtures, etc., £120; and Machinery and Plant, £1,500. The costs of realisation amounted to £390. Prepare accounts showing the realisation and the position of the partners after the realisation and distribution to creditors had been carried out.

Books of X, Y, and Z.

Dr. ASSIGNED BOOK DEBTS ACCOUNT. *Cr.*

			£				£
	To Sundry Debtors		600		By Sundry Secured Creditors		570
					" Loss on Realisation		30
			£600				£600

Dr. SECURED CREDITORS' ACCOUNT. *Cr.*

			£				£
	To Proceeds of Assigned Book Debts		570		By Balance	*b/d.*	500
					" Cash		70
			£570				£570

REALISATION ACCOUNT.

Dr.		£	Cr.		£
To Book Value of Sundry Assets—			By Cash Realised—		
Debtors . .		3,000	Debtors . .		2,600
Stock-in-Trade		3,380	Stock-in-Trade		2,900
Furniture, Fixtures, etc. .		200	Furniture, Fixtures, etc. .		120
Machinery and Plant . .		1,800	Machinery and Plant . .		1,500
,, Loss on Assigned Book Debts .		30	,, Balance, being Loss on Realisation . .	c/d.	1,680
,, Expenses of Realisation .		390			
		£8,800			£8,800
To Balance . .	b/d.	1,680	By Capital Accounts—		
			X . . .		560
			Y . . .		560
			Z . . .		560
		£1,680			£1,680

CASH ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
To Balance . .	b/d.	20	0	0	By Expenses of realisation . .		390	0	0
,, Realisation A/c.—					,, Sundry Creditors—				
Debtors . .		2,600	0	0	Open A/cs. .		3,000	0	0
Stock-in-Trade .		2,900	0	0	Bills Payable .		1,500	0	0
Furniture and Fixtures .		120	0	0	O. P. Q. Bank .		500	0	0
Machinery and Plant . .		1,500	0	0	,, Balance . .	c/d.	1,820	0	0
,, Secured Creditors, Surplus from Assigned Book Debts . .		70	0	0					
		£7,210	0	0			£7,210	0	0
To Balance . .	b/d.	1,820	0	0					

SUNDRY LIABILITIES ACCOUNT.

Dr.		£	s.	d.	Cr.		£	s.	d.
To Cash—					By Sundries—				
Open A/c.'s .		3,000	0	0	Open A/cs. .		6,000	0	0
Bills Payable .		1,500	0	0	Bills Payable .		3,000	0	0
O.P.Q. Bank .		500	0	0	O.P.Q. Bank .		1,000	0	0
,, Balance . .	c/d.	5,000	0	0					
		£10,000	0	0			£10,000	0	0
To Capital Accounts—					By Balance . .	b/d.	5,000	0	0
X . . .		1,666	13	4					
Y . . .		1,666	13	4					
Z . . .		1,666	13	4					
		£5,000	0	0			£5,000	0	0

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

		X			*Y*			*Z*					*X*			*Y*			*Z*		
		£	s.	d.	£	s.	d.	£	s.	d.			£	s.	d.	£	s.	d.	£	s.	d.
To Balances .	*b/d*	800	0	0	500	0	0	200	0	0	By Liabilities Account . .		1,666	13	4	1,666	13	4	1,666	13	4
,, Loss on Realisation . .		560	0	0	560	0	0	560	0	0											
,, Balances .	*c/d*	306	13	4	606	13	4	906	13	4											
		£1,666	13	4	£1,666	13	4	£1,666	13	4			£1,666	13	4	£1,666	13	4	£1,666	13	4
											By Balances .	*b/d*	306	13	4	606	13	4	906	13	4

THE LIQUIDATION OF COMPANIES

Limited companies cannot be made bankrupt, the procedure which takes the place of bankruptcy on the insolvency of a limited company being known as "winding up." Companies may be wound up in three different ways, viz. :—

(1) Voluntary winding up ;
(2) Winding up under the supervision of the Court ; and
(3) Winding up by the Court, more usually described as "Compulsory Winding Up."

A voluntary winding up may be either "a members' voluntary winding up" or "a creditors' voluntary winding up." It is a members' voluntary winding up if the directors, before the date of the resolution to wind up, make and file a statutory declaration with the Registrar of Companies that the company is, in their opinion, solvent and will be able to pay its debts in full within twelve months from the commencement of the winding up. Otherwise it is a creditors' voluntary winding up. In a members' winding up the company appoints the liquidator and the creditors have no control over the winding up. In a creditors' winding up, both members and creditors may nominate persons to act as liquidator. If different persons are nominated, or if the members fail to make a nomination, the creditors' nominee acts as liquidator. If the creditors fail to nominate a person as liquidator, the members' nominee will be appointed.

In a winding up under supervision the liquidator may be one appointed by the company, but the Court may on application appoint the liquidator.

In a compulsory winding up the Official Receiver is appointed in the first instance, but at meetings of creditors and shareholders subsequently held another person may be appointed, subject to the approval of the Court.

Companies are wound up under varying circumstances, and insolvency need not necessarily be the cause. Amalgamation with another company, reconstruction, or disposal of the company's entire business, amongst other causes, may be the reasons for winding up. A liquidator must always be appointed, and, in some cases, a "committee of inspection" is appointed to supervise and control the acts of the liquidator.

It is the duty of the liquidator to collect debts due to the company, to dispose of the company's assets, to distribute the proceeds in satisfaction of the claims of the creditors of the company, and to apply any balance remaining amongst the shareholders in accordance with their rights.

Voluntary Winding Up.

When, in the case of voluntary winding up, the liquidation is not completed within one year, the liquidator is required by Sections 284-285 of the Companies Act, 1929, to make periodical returns of his receipts and payments, from the date of his appointment until the winding up is completed. Upon the conclusion of the winding up a summary of the liquidator's receipts and payments must be submitted to the creditors and contributories (shareholders). An example of such an account is appended.

EXAMPLE.

The following particulars relate to the Patent Steel Safe Company, Limited (in Voluntary Liquidation). Prepare the Liquidator's Final Account, allowing for his remuneration: 2% on the amount realised, and 2% on the amount distributed to the Unsecured Creditors :—

	£
Preferential Creditors	1,000
Unsecured Creditors	3,200
Debentures	1,000
The Assets realised the following sums :—	
Land and Buildings	2,000
Plant and Machinery	1,865
Fixtures and Fittings	100

The Liquidation Expenses amounted to £100 14s

THE PATENT STEEL SAFE COMPANY, LIMITED.
(In Voluntary Liquidation.)

ACCOUNT OF LIQUIDATOR'S RECEIPTS AND PAYMENTS.

Receipts.	£	s.	d.	*Payments.*	£	s.	d.
To Proceeds of Sale of Assets :—				By Liquidation Expenses	100	14	0
Land and Buildings				,, Liquidator's Remuneration—			
(Book value £....)	2,000	0	0	2% on amount realised, £3,965	79	6	0
Plant and Machinery (Book value £....)	1,865	0	0	2% on amount distributed to unsecured creditors, £1,750	35	0	0
Fittings and Fixtures (Book value £....)	100	0	0	,, Preferential Creditors	1,000	0	0
				,, Debenture Holders	1,000	0	0
				,, Unsecured Creditors— Dividend of 10s. 11¼d. in £ on £3,200.	1,750	0	0
	£3,965	0	0		£3,965	0	0

NOTE.—The liquidator's remuneration on amount distributed to unsecured creditors is calculated as follows :—

Balance available after payment of all prior creditors including liquidator's remuneration based on assets realised . . £1,785

2% on amount available *after* providing for the liquidator's remuneration :—

$$\tfrac{2}{102} \times £1,785 = £35.$$

The Act provides that the liquidator must in all cases send a copy of the final account to the Registrar, and must also make a return of the fact and date of the final general meeting of the company within one week after such meeting. It is also pro-

vided that in a creditors' voluntary winding up the directors must lay before the creditors' meeting a full Statement of Affairs, a list of the company's creditors, and the estimated amount of their claims.

Winding Up under Supervision.

A "Winding up under the Supervision of the Court" is really a voluntary liquidation over which the Court exercises supervision. The liquidator is frequently appointed by the shareholders, but sometimes the Court appoints an additional or substitutional liquidator. In most cases, the winding-up order limits the liquidator's authority in certain matters and gives him directions as to how to proceed on other points. Returns of the liquidator's receipts and payments are made in the same manner as in the case of a voluntary winding up.

Compulsory Winding Up.

The procedure in compulsory winding up by the Court very closely resembles that in the case of the bankruptcy of a sole trader or partnership. The liquidator is nominated by the creditors and contributories, but the actual appointment is made by the Court. Until a liquidator is appointed, the Official Receiver in Company Liquidations acts in that capacity.

A Statement of Affairs and Deficiency Account must be prepared and lodged with the Companies Liquidation Department of the Board of Trade. A skeleton statement is given on pages 634 to 636, from which it will be seen that the form is compiled on the same principles as a bankruptcy statement, except that the Statement of Affairs is divided into two portions, the first portion showing the deficiency (or surplus) as regards creditors, and the second part the deficiency (or surplus) as regards shareholders (contributories). These statements must be supported by schedules containing details of the various items. It should be noted that the Deficiency Account covers a period *three* years prior to the commencement of the winding up (or since the formation of the company if this is less than three years prior to the liquidation), whereas in bankruptcy the period covered by the Deficiency Account is one year only unless the Official Receiver fixes some other period. Further, in bankruptcy the Deficiency Account will only disclose the *net* profit or loss of the bankrupt, but in liquidation the *gross* profit or loss and details of the expenditure must be shown.

Any uncalled capital is not included as an asset in the Statement of Affairs, but is shown in a note at the foot of the first portion thereof.

Debentures carrying a fixed charge are treated in a similar manner to secured or partly secured creditors, whereas debentures carrying a floating charge are treated in a similar manner to preferential creditors.

No. C. 26.—*Statement of Affairs. Company's Winding up.*

In the Court of

COMPANIES (WINDING-UP). *No. of 19*

IN THE MATTER OF THE COMPANIES ACT, 1929,

AND

* Insert full name of Company.

IN THE MATTER OF * ______________________ LIMITED

STATEMENT OF AFFAIRS on the day of 19 , the date of the Winding-up Order.

(I.) AS REGARDS CREDITORS.

Gross Liabilities. £ s. d.	Liabilities.	Expected to Rank. £ s. d.	Assets.	Estimated to produce. £ s. d.
	Debts and Liabilities, viz. :—		(a) Property as per list " H," viz. :—	
	(a) Unsecured Creditors, as per list " A " (*State number*)		(a) Cash at Bankers	
			(b) Cash in hand	
			(c) Stock-in-trade .. .. .. (Estimated cost, £ : :)	
	(b) Creditors fully secured (not including debenture holders) as per list " B." .. .. £ s. d.		(d) Machinery	
	Estimated value of securities		(e) Trade fixtures, fittings, utensils, &c.	
			(f) Investments in shares, &c. ..	
			(g) Loans on mortgage	
			(h) Other property, viz. :—	
	Estimated surplus £		(b) Books debts (debtors), as per list " I," viz. :—	
	Carried to list " C " £		Good	
	Balance to contra (d) £		£ s. d.	
	(c) Creditors partly secured, as per list " C "		Doubtful	
	Less estimated value of securities ..		Bad	
			£	
	Estimated to rank for dividend ..		Estimated to Produce	
	£ s. d.		£ s. d.	
	(d) Liabilities on bills discounted other than the Company's own acceptances for value, as per list " D " .. : :		(c) Bills of Exchange or other similar securities on hand, as per list " J "	
	Of which it is expected will rank for dividend		Estimated to produce	
			(d) Surplus from securities in the hands of creditors fully secured (per contra) (b)	
	£ s. d.		£ s. d.	
	(e) Other liabilities, as per list " E " .. .. : :		(e) Unpaid calls (debtors) as per list " K " :—	
	Of which it is expected will rank for dividend		Estimated to produce	
	£ s. d.		Estimated total assets ..	
	(f) Preferential Creditors for rates, taxes, wages, &c., as per list " F " deducted contra		*Deduct* preferential creditors, as per contra (f)	
			Estimated amount available to meet claims of debenture holders.	
	(g) Loans on debenture bonds, as per list " G " deducted contra .. (holders)		*Deduct* loans on debenture bonds secured on the assets of the Company as per contra (g)	
	£		Estimated amount available to meet unsecured creditors subject to cost of liquidation	
	Estimated surplus (if any) after meeting liabilities of Company, subject to cost of liquidation		Estimated deficiency of assets to meet liabilities of the Company, subject to cost of liquidation	
	£		£	

The nominal amount of unpaid capital liable to be called up is £ : : which is [available to meet above deficiency] or [charged to debenture-holders], or as the case may be.

(II.) AS REGARDS CONTRIBUTORIES.

		£	s.	d.	£	s.	d.		£	s.	d.
	Capital issued and allotted, viz. :—							Estimated Surplus as above (if any) subject to costs of Liquidation			
	——Founders' Shares of £ per Share (——Shareholders)										
(a) Where capital is issued as partly paid up, the form should be altered accordingly.	(a) Issued as fully-paid.										
	Amount called up at £ per Share, as per List "L"										
	——Ordinary Shares of £ per Share (——Shareholders).										
	(a) Issued as fully-paid.										
	Amount called up at £ per Share, as per List "M"										
	——Preference Shares of £ per Share (——Shareholders).										
	(a) Issued as fully-paid.										
	Amount called up at £ per Share, as per List "N"										
(b) Add particulars of any other capital.	(b)										
	Amount (if any) paid in advance of call										
	£										
	Less unpaid calls estimated to be irrecoverable .. .. .. £										
	Add deficiency to meet Liabilities as above ..							Total deficiency as explained in Statement "O" ..			
	£							£			

Statement of Affairs. Company's Winding up.

LIST "O. (1)." Deficiency Account.

(1) Deficiency Account where Winding-up Order made WITHIN THREE YEARS OF formation of Company.

	£	s.	d.
I. Gross profit (if any) arising from carrying on business from date of formation of Company to date of Winding up Order (as per Trading Account annexed)			
II. Receipts (if any) during same period from undermentioned sources :—			
Interest on Loans			
Interest on Deposits			
Transfer Fees			
Amounts paid on Shares issued and subsequently forfeited (as per list annexed)			
III. Other Receipts (if any) during same period not included under any of the above headings, viz :—			
IV. Deficiency as per Statement of Affairs (Part II.)			
Total amount to be accounted for .. .. (2) £			

	Amount Discharged £	s.	d.	Due at date of Winding up Order. £	s.	d.	£	s.	d.
I. Expenditure in carrying on business from date of formation of Company to date of Winding-up Order, viz. :—									
II. General Expenditure :—									
Salaries									
Wages not charged in Trading Account									
Rent									
Rates and Taxes									
Law Costs									
Commission									
Interest on Loans									
Interest on Debentures ..									
Miscellaneous Expenditure (as per details annexed) ..									
III. Directors' Fees from date of formation of Company to date of Winding up Order									
IV. Dividends declared during same period									
V. Losses and Depreciation written off in Company's books (1) :—									
Bad Debts..									
Losses on Investments									
Depreciation on Property									
Preliminary Expenses									
VI. Losses and Depreciation not written off in Company's Books, now written off by the Directors (1) :—									
Bad Debts..									
Losses on Investments									
Depreciation on Property									
Preliminary Expenses									
VII. Other Losses and Expenses									
Total amount accounted for .. .. .. (2) £									

NOTES.—(1) Where particulars are numerous they should be inserted in a separate Schedule.
(2) These figures should agree.

Signature ______________________

Dated ______________________ 19

SUMMARY OF ACCOUNTS.

In the

In the Matter of the Companies Act, 1929,

AND

In the Matter of

Limited.

SUMMARY OF LIQUIDATOR'S ACCOUNTS,

From 19 , to 19 .

Dr. *Issued by the Board of Trade under the provisions of the Companies Act, 1929.* Cr.

	RECEIPTS. £	s.	d.		PAYMENTS. £	s.	d.
To Balance				By Balance			
,, Receipts, viz. :—				,, Board of Trade and Court Fees ..			
(a) Cash at Bankers				,, Law Costs of Petition, including costs of any person appearing in the petition whose costs are allowed			
(b) Do. in hand				,, Costs of Solicitor to Liquidator ..			
(c) Stock-in-Trade				,, Other Law Costs			
(d) Machinery, &c.				,, Special Manager's Charges			
(e) Trade Fixtures, &c.				,, Allowance for preparing Statement of Affairs			
(f) Investments in Shares, &c. ..				,, Fees of Official Receiver as Provisional Liquidator			
(g) Loans on Mortgage				,, Charges of Provisional Liquidator, other than Official Receiver			
(h) Other Property, viz. :—				,, Remuneration of Liquidator			
,, Book Debts—good				,, Auctioneer's and Valuer's Charges ..			
,, Do. doubtful and bad ..				,, Shorthand Writer's Charges			
,, Bills of Exchange				,, Other Charges			
,, Surplus from Securities				,, Costs of Possession			
,, Receipts per Trading Accounts ..				,, Do. of Notices in "Gazette" and Local Papers..			
,, Calls due at date of Winding-up Order				,, Incidental Outlay			
,, Do. made by Liquidator				Total Costs and Charges			
Less— (£ s. d.)				,, Creditors and Contributories :— (£ s. d.)			
Payments to Debenture holders				Preferential Creditors			
Do. to Execution and other Secured Creditors				Unsecured Creditors divd of in the £ on £			
Do. per Trading Account				Return to Contributories at the rate of per Share			
				Balance			
£				£			

Creditors and Contributories can obtain any further information on application to the Liquidator.

day of 19 .

Liquidator.

Address

When shares are only partly paid the liquidator will make a call in order to pay off liabilities as far as possible and to adjust the position between the different classes of shareholders. The liquidator should avoid making a call greater than is really required, otherwise a return of cash may be due to the shareholders upon whom the call was made.

The liquidator's accounts must be kept in the form prescribed by the Board of Trade. A Record Book is necessary in which are entered the minutes of all proceedings and transactions at meetings of creditors, contributories, and committees of inspection. The liquidator must also keep an official Cash Book and, where any trading is necessary for the beneficial conduct of the liquidation, a Trading Account. These books and the relative vouchers are periodically audited by the Committee of Inspection and the Board of Trade. A statement of the liquidator's receipts and disbursements must be filed every six months, and when the whole of the assets have been realised and distributed, the final account must be audited and submitted to the Board of Trade. A *pro-forma* final summary is given on page 637. This final summary shows approximately the order in which the assets are distributed, but it may be added that the preferential payments in a winding up are the same as in bankruptcy, except that the landlord has no power of distraint after the commencement of the winding up.

EXERCISE 15.

A. *A* and *B*, equal partners, dissolve partnership on the 31st December, when their Balance Sheet showed the following position:—

BALANCE SHEET.

	£		£
Sundry Creditors	2,100	Plant and Machinery	4,000
Capital—*A*	4,000	Stock-in-Trade	2,100
Capital—*B*	2,000	Sundry Debtors	2,000
	£8,100		£8,100

The total Assets realise £5,000, and the Sundry Creditors are discharged, less 3% discount. The costs of Realisation are £100. Prepare Realisation Account, Cash Account, and Partners' Capital Accounts.

B. James and Pratt were in partnership, sharing profits and losses as to James two-thirds and Pratt one-third. On 31st March, they decided to wind up the partnership, at which date their liabilities were £13,500, and there was due to James (loan to the firm) £6,000. The capital was: James, £4,200, and Pratt, £4,500. After payment of expenses the realisation of the assets amounted to £21,600. Prepare accounts showing the result of the realisation.

C. *A*, *B*, and *C* decided to dissolve partnership on the 31st March, 1941; at 30th September, 1940, their capitals were £7,500, £5,000, and £2,500 respectively. The partners shared profits and losses in the proportion of 7, 3, and 2, and were entitled to interest on their capital at the rate of 5% per annum. At 31st March, 1941, the whole of the assets had been realised and the whole of the liabilities discharged, with the exception of certain expenses in connection with the winding up, which amounted to £100, and the cash available amounted to £9,660, being £9,600 plus £60 interest. Prepare accounts showing the final settlement with each partner.

D. Oldfield and Young decided to dissolve partnership as on 31st December, and the following represents the statement of affairs at that date :—

Liabilities.	£	*Assets.*	£
Sundry Creditors	3,600	Property—	
Mortgage on Property—		Warehouse	1,000
Warehouse	500	Retail Shops	2,000
Shops	1,000	Fixtures	1,700
Loans	500	Horses and Carts	250
Capital—		Stock—	
Oldfield	5,000	Warehouse	3,000
Young	5,000	Shops	4,380
		Debtors	3,000
		Cash in hand	120
		Bank	150
	£15,600		£15,600

It was agreed that Oldfield should take over the warehouse, subject to the mortgage and the warehouse stock, and that Young should take over all the rest of the assets at the book values, subject to an allowance of £250 for depreciation of fixtures and to an allowance of 5% of the debts for bad debts. Young also undertook to discharge all the liabilities.

Prepare accounts showing the winding up of the firm.

E. Brown & Davis, Merchants and Agents, who share profits and losses equally, decide to dissolve partnership. During the partnership Brown canvassed the North of England and Davis the South, each paying his own travelling expenses, etc. During the year Brown received by way of commission £440 on behalf of the partnership, and made the following disbursements: Travelling Expenses, £75; Rent, etc., £20. Davis received £720, and his disbursements were as follows: Travelling Expenses, £120.

The stock of goods on hand at date of dissolution was valued at £100, of which Brown took £40 and Davis £60.

Draw up an Adjustment Account showing amount due to or by each partner.

F. Locke and Edwards, trading as metal merchants, decided to dissolve partnership and retire on 30th June, each having a private income.

At that date their Balance Sheet was as follows :—

BALANCE SHEET.

Liabilities.	£	*Assets.*	£
Sundry Creditors	3,000	Horses, Carts, and Trade Utensils	1,425
Bills Payable	1,125	Fixtures, Fittings, etc.	200
Capital Accounts—		Stock-in-Trade	5,875
Locke	3,500	Sundry Debtors	1,875
Edwards	2,375	Cash at Bank	600
		Cash in hand	25
	£10,000		£10,000

The Sundry Debtors realised £1,500; Stock, £5,125; Fixtures and Fittings, £100; and Horses, Carts, and Trade Utensils, £1,000.

The costs of winding up and realisation amounted to £210. Draw up accounts giving effect to these transactions and showing how the balance of cash was distributed. The partners shared profits and losses equally.

G. The following is the Balance Sheet of Francis and Clifford at the date when they agree to sell their business to a limited company :—

BALANCE SHEET.

Liabilities.	£	*Assets.*	£
Sundry Creditors	2,000	Machinery and Plant	3,000
Loan—Clifford	1,000	Stock-in-Trade	4,600
Capital—		Sundry Debtors	6,000
Francis	6,000	Cash at Bank and in hand	400
Clifford	5,000		
	£14,000		£14,000

The partners share profits and losses equally. They decide to sell to the company the Goodwill, Machinery and Plant, and Stock for £9,000; and to collect the book debts and pay off their creditors themselves. They receive from the company £2,000 in Mortgage Debentures, £2,000 in fully-paid Shares of £1 each, and £5 000 in cash. The debts were received less an average discount of 3%, and the creditors were paid less an average discount of 2½%. There was a bad debt of £80. Francis agreed to take the Debentures and Clifford the Shares on account of the amounts due to them. Prepare accounts showing the final result as regards the partners.

H. Crake, Sheen, and Wells are in business as tailors, sharing profits and losses equally. On 30th June they decide to dissolve and wind up the business. Crake is insolvent and unable to contribute towards any loss on the winding up, being indebted to the firm in the sum of £500. Their assets and liabilities at the date named were as follows :—

ASSETS.

	£
Cash at Bank	500
Sundry Debtors	1,000
Stock-in-Trade	1,800
Fixtures and Fittings	200

LIABILITIES.

	£
Sundry Trade Creditors	1,400
Creditors for Rent, Rates, etc.	50
Sheen—Capital	1,275
Wells— „	1,275

The assets realise—Debtors, £750; Stock, £1,000; and Fixtures, etc., £130. The costs of realisation were £80.

The Trade Creditors were found, on settlement, to have been overstated by £60. Prepare accounts showing the effect of the realisation and the Partners' Capital Accounts.

I. Henry Jones filed his petition in Bankruptcy on 30th June. His books showed the following balances :—

	£	£
Cash in hand	10	
Fixtures and Fittings	250	
(Estimated to produce £80.)		
Stock in Trade	1,800	
(Estimated to produce £1,200.)		
Sundry Creditors—open accounts		2,000
Do. —bills payable		2,200
Sundry Debtors	5,000	
Good £1,000.		
Doubtful £2,000 (estimated at 50%).		
Bad £2,000.		
Bank overdraft		1,200
Capital		1,660
	£7,060	£7,060

Liability on bills discounted £500, £100 expected to rank.

His household furniture, etc., was valued at £250.

He owned the house he lived in—it was valued at £750—and he had a mortgage on it of £600 at 4%. Interest paid to the preceding 31st December.

Preferential creditors amounted to £35 (included in Sundry Creditors) and £15 for rates on his house.

Prepare a Statement of Affairs.

J. Prepare a Statement of Affairs from the following particulars of the accounts of Andrew Ashton on 30th September :—

	£	s.	d.
Unsecured Creditors	7,366	13	4
Fully secured Creditors	3,290	0	0
Partly secured Creditors	1,588	0	0
Securities held by secured Creditors	4,035	13	4
Securities held by partly secured Creditors	773	13	4
Rent, Rates, Taxes, and Wages (of which £200 is preferential)	283	0	0
Plant and Machinery estimated at one-third of book value, which is	4,200	0	0
Office Furniture	16	13	4
Cash in hand	1	13	4
Investments	1,195	0	0
Book Debts (good)	1,000	0	0
Doubtful Debts valued at	233	0	0

There is a life policy on *A's* life on which 20 premiums are paid up of £8 each, and the surrender value is two-fifths of the paid-up premiums.

How much in the £ is available for the unsecured creditors ?

K. From the following particulars prepare a Statement of Affairs of William Watson, the amounts given being the values, as far as ascertainable, for this purpose :—

	£
Creditors unsecured	20,000
„ partly secured (value of security, £4,000)	5,000
Cash Creditors (unsecured)	3,000
Rent, Wages, etc. (preferential)	150
Trade Utensils, Fixtures, etc.	500

	£
Horses and Carts	150
Stock-in-Trade	800
Cash at Bank	1,500
Cash in Hand	50
Bills Receivable under Discount (£200 expected to rank for Dividend)	750
Sundry Debtors (viz.: £2,800 regarded as good; £100 doubtful, estimated to produce £50; and £100 bad) .	3,000

L. The Capital in the business of H. Simmons on 31st December, 1940 was £1,500. During the year ended 31st December, 1941, he sustained a trading loss of £780, and his drawings out of the business were £700. Owing to depreciation of stocks and his unsatisfactory financial position, he was compelled to file his petition, and a Receiving Order was made against him on 31st December, 1941. His Assets consisted of—

(*a*) Book Debts £1,000, of which £800 were considered to be good, and the remainder were estimated to produce £100.
(*b*) Stock-in-trade (cost £1,500), estimated to produce £900.
(*c*) Plant and Machinery (cost £1,600), estimated to produce £1,100.
(*d*) Freehold Dwelling House valued at £1,200, the Deeds of which were lodged with the Bank as security for an overdraft on business account of £800.
(*e*) Life Policy of Assurance (surrender value £600), given as part security for a private loan of £1,000.

His Unsecured Creditors amounted to £4,000, and he owed £80 to his Clerk, being salary for the four months ended 30th November, 1941.

Prepare his Statement of Affairs, and Deficiency Account.

M. Samuel Hobson, in business in the city, finds himself insolvent. From the various books and papers in his possession the following particulars as to his financial position are forthcoming. Prepare the Statement of Affairs for submission to his creditors and a Deficiency Account in the ordinary form:—

	£
Sundry Debtors: Good, £1,280; doubtful, £2,800 (estimated to produce £1,000); bad, £700 . . .	4,780
Sundry Freehold Houses, etc. (estimated to produce £2,000)	3,300
Shares: 1,000 Ordinary Shares in the Cable Telegraph Co. valued at par	1,000
Mining and Railway Shares (of which £2,500 is held as security by partly secured creditors, and the balance by fully secured creditors) valued at par	9,450
Loss through the unsuccessful defence of an action at law	5,420
Business expenses	3,200
Creditors: unsecured	16,740
Do. partly secured	5,420
Do. fully secured	3,110
Preferential claims for salaries and rent	500
Private drawings	1,200
Samuel Hobson Capital Account	3,800
Cash at Bank	420
Bills receivable, good	800

N. M. P. is appointed liquidator of a company in voluntary liquidation on 25th March, and the following balances are extracted from the books at that date:—

	£		£
Sundry Creditors	2,000	Cash in hand	100
Debenture Holders	5,000	Book Debts	6,000
Reserve for Bad Debts	1,000	Machinery	3,000
Bank Overdraft	1,800	Investments	600
Capital issued	8,000	Stock-in-Trade	100
(8,000 Shares of £1 each)		Calls in arrear	500
		Leasehold Properties	4,000
		Profit and Loss Account	3,500
	£17,800		£17,800

Prepare a Statement of Affairs, to be submitted to the meeting of creditors. The Machinery is valued at £6,000, the Leasehold Properties at £7,300, Investments at £400, Stock at £200, Bad Debts are £200, Doubtful Debts £400, estimated to realise £200. The Bank's overdraft is secured by deposit of the title-deeds of the leasehold properties. Preferential Creditors for Rates, Taxes and Wages are £100. Telephone rent owing, £8.

O. The following Balance Sheet represented the position of a Company when it went into voluntary liquidation on 30th June :—

BALANCE SHEET.

Liabilities.		£	*Assets.*	£
Capital :—			Goodwill	2,000
Nominal—			Plant and Machinery	2,170
10,000 Ordinary Shares			Stock	3,780
of £1 each	£10,000		Sundry Debtors	2,515
			Cash in hand	15
Issued—			Profit and Loss Account (Balance)	5,185
4,940 Ordinary Shares of £1				
each, fully paid		4,940		
Sundry Creditors—	£			
Preferential	550			
Unsecured	9,980			
		10,530		
Bank Overdraft (unsecured)		195		
		£15,665		£15,665

The Liquidator, whose remuneration was agreed at $2\frac{1}{2}\%$ on the amount realised, and 1% on the amount distributed to the unsecured creditors, realised the assets as follows :—

	£
Plant and Machinery	2,230
Stock	3,170
Sundry Debtors	1,905
Cash	15

A first and final dividend was distributed to creditors, after paying expenses of the liquidation, which amounted to £57.

You are required to prepare the Liquidator's Final Account, showing how much in the £ the dividend amounted to.

P. The Hardware Co., Ltd., went into voluntary liquidation on 14th January, the capital of the Company being 4,000 fully paid Ordinary Shares of £1 each. The unsecured creditors' claims amounted to £2,700 (including Bank overdraft £700, and a loan from one of the Directors of £900); Preferential claims were £45; interest due, £30. The assets realised—Stock, £2,000; Book Debts, £3,800; and Fixtures and Sundries, £50. The Liquidator's remuneration was fixed at £220, and his expenses amounted to £55.

Prepare the Statement of Account to be submitted by the Liquidator at the final meeting of shareholders.

Q. The Sensational Theatre Co., Ltd., passed a resolution for a members' voluntary winding up on 1st January. The Company's articles contained the following provision:—

That in the event of winding up, any surplus after discharging the whole of the liabilities of the Company should be applied:—

(1) In redeeming the preference share capital of the company.
(2) In redeeming the ordinary share capital of the company.
(3) The balance remaining, if any, to be divided equally between preference, ordinary and deferred shareholders.

The position of the Company at the date of the resolution to wind up was as follows:—

Issued Share Capital—

5,000 Preference Shares of £1 each (fully paid).
5,000 Ordinary Shares of £1 each (fully paid).
5,000 Ordinary Shares of £1 each (15s. 0d. paid).
5,000 Deferred Shares of £1 each (2s. 6d. paid).

The assets realised £25,750, and the liabilities amounted to £7,500. The costs of the liquidation (including the liquidator's remuneration) were £250. The liquidator duly made calls of 5s. 0d. on the Ordinary Shares, and 2s. 6d. on the Deferred Shares, and the whole of the cash was received with the exception of the call on 1,000 Deferred Shares.

Prepare the liquidator's final Statement of Account, showing the amounts returned to the shareholders.

CHAPTER XVI

COST ACCOUNTS

In the foregoing chapters consideration has been given to the methods of compiling the financial accounts of concerns with the object of recording the transactions of the respective businesses for each period, and of showing the final results of such transactions.

In the case of trading, as distinguished from manufacturing concerns, the information given in these accounts is usually sufficient, but it will be readily understood that a manufacturer is not satisfied merely to know at the end of a period that a profit or a loss of a certain amount has been made; he must know exactly *how* such a result has been obtained. Hence a manufacturer must analyse his expenditure in such a way as to indicate precisely what each job, contract, process, or other unit has cost him; what proportion of the cost has been expended in materials, wages, and expenses; and, finally, whether he has made a profit or a loss on each unit. To do this it is necessary to keep a separate set of accounts, known as "Cost Accounts." It should, however, be borne in mind that although the Cost Accounts are distinct from the Financial Accounts, they should be capable of being agreed therewith.

Thus, the total charges entered in the Cost Accounts for materials consumed during the trading period should agree with the total cost of materials debited in the financial Manufacturing Account for the same period, while the total wages charged in the Cost Accounts should correspond with the total wages paid as shown in the financial books. Similarly, the totals of the various expenses charged in the Cost Accounts should be capable of being agreed with the total expenses shown in the financial books.

As in pure accountancy, it is possible to base the costing system upon double-entry principles, as will be explained later on in the chapter. By adopting this method it is possible to obtain a more detailed comparison between the two sets of accounts, and also to make each set complete in itself.

Cost Accounts are essentially analytical in nature, and it is, therefore, impossible to devise a standard system which will suit any particular business. Hence the system of costing

adopted in any special case must be designed to suit the particular business under consideration. The underlying principles, however, are fairly definite, and the greater part of this chapter will be devoted to outlining these principles, applying them to particular businesses only where this is necessary for the purpose of illustration.

The Objects of Cost Accounts.

Although the main purpose of a system of Cost Accounts is so to analyse and allocate the expenditure of a business that it is possible to ascertain the cost of each job, contract, or process carried out, this is by no means its sole function, and a manufacturer who employs Cost Accounts with nothing but this end in view is only deriving a fraction of the maximum possible benefit which he might obtain therefrom. Thus, Cost Accounts, if properly utilised, will also serve as :—

(1) A record of *results* for periodical statistics and the preparation of interim profit and loss accounts.
(2) A guide in future *estimates* and in quoting prices.
(3) A stimulus to *economical* processes.
(4) A help in increasing *production.*
(5) A means of detecting *losses and leakages.*
(6) A safeguard against *waste*, and a means of controlling expenses.
(7) A means of reducing *prices* in order to obtain a larger demand.
(8) A safeguard against the excessive accumulation of stocks of raw materials, and a means of indicating obsolete or slow-moving items.

The Different Classes of Cost Accounts.

As already shown, it is impracticable to lay down a system which could be effectively employed in all businesses. It is possible, however, to arrive at certain broadly defined classes of cost accounts which are suitable for various types of industries. The most usual grouping of these classes is as follows :—

(1) Terminal (or Job) Cost Accounts, a suitable system where it is desired to obtain the cost of each of a number of contracts, operations or undertakings which are entirely distinct and of a non-recurring nature, e.g., builders, engineers, etc. This system is generally suitable to all industries that produce a definite article or undertake work of a constructional nature.
(2) Process Cost Accounts, employed where the product passes through a number of distinct stages or pro-

cesses; the cost accounts show the cost of each process, e.g., chemical works, etc. It is particularly suitable in industries where by-products and residuals naturally occur.

(3) SINGLE (OR OUTPUT) COST ACCOUNTS, applicable to businesses supplying a product of a uniform type; the accounts show the cost of a "natural" unit of output, e.g., a ton of saleable coal (in a colliery). The average cost per unit over a given period is obtained by dividing the expenditure by the units of production.

(4) MULTIPLE COST ACCOUNTS, applicable to businesses where the products differ considerably in type, size and value, and where similar operations are performed on very different articles, as, for example, in a general engineering firm. Each product, or class of product, is costed separately.

(5) OPERATING (OR WORKING) COST ACCOUNTS, employed by undertakings which produce services rather than goods, e.g., tramways, railways, etc. The unit is a car-mile, passenger-mile, etc., as the case may be.

(6) DEPARTMENTAL COST ACCOUNTS, in which, as the name implies, the cost of each department is obtained separately. This system is employed in businesses which are divided into a number of departments which are virtually small factories in themselves.

The methods outlined in this chapter for the recording and analysis of materials, labour, and expenses can be applied, with slight modification according to circumstances, to each of the above classes, the principal difference being in the method of presenting the final results. Examples of the different classes are shown at the end of the chapter.

In dealing with each class it will be useful to distinguish between "cost finding" and "estimating." The first may be defined briefly as the systematic and detailed recording of the expenditure *actually incurred* in the manufacture or extraction of a pre-determined unit of output, or in the rendering of a given unit of service.

"Estimating," on the other hand, is the *predetermining* of the *probable* transactions under the headings of the three elements of cost in the anticipated manufacture or extraction of a product, the working of a process, or the supply of a service. The principal distinctions between cost finding and estimating are as follows:—

COST FINDING	ESTIMATING.
Is concerned with the *actual* cost of materials used, or wages paid.	This is performed having regard to the market prices at the time of estimating.
Only *actual* costs should be taken into account.	The future position in respect of prices becoming higher or lower is considered.
All expenses must be fairly charged, and each individual item priced and considered independently of all others.	To secure orders, profits may be reduced to *nil*, or the risk of a slight loss may be taken in exceptional cases.
	Estimates may be prepared with the aid of previous cost accounts, which serve as a guide.

The Elements of Cost.

The first essential to good cost finding is accuracy, and in every costing system there must be reliable sources of accurate information. The three principal elements of cost are—

(1) Materials ;
(2) Labour ;
(3) Expenses ;

and for the purpose of analysing costs each item of expenditure must be classified into one of these three groups.

Each of these groups may be again divided into—

(1) Direct items ;
(2) Indirect items.

DIRECT ITEMS are those which can be directly charged to the particular unit (job, contract, or process, as the case may be) on which they were expended, while INDIRECT ITEMS (also termed *Establishment Charges* or *Overhead Charges*) are those which for any reason cannot be definitely allocated to particular units. For example, direct labour would include the wages of operatives engaged directly on the particular job or contract ; direct materials would include special purchases and goods drawn from store for particular jobs ; while expenses incurred by operatives in travelling to a job away from the works, or the cost of hiring special plant for use on the job, would be direct expenses. Indirect labour may include the wages of foremen and shop cleaners ; indirect materials may include solder, oil, waste, and similar items which may not be capable of direct allocation ; while maintenance of plant and machinery, power and lighting, etc., are examples of indirect expenses.

It must be appreciated, however, that items which are "direct" in one business may be "indirect" in another. A contractor can allocate the wages of a foreman engaged on a particular contract to that contract (his wages are therefore *direct*), but a foreman in an engineering works may supervise the manufacture of many different articles, and his wages will be *indirect*.

The Total Cost of each unit may, therefore, be analysed as follows :—

Direct Labour
Direct Materials } = Prime Cost.
Direct Expenses
Factory (or Works) Overheads
Charges embracing :—
Indirect Labour
Indirect Materials
Indirect Factory Expenses
} = Factory Cost (or Works Cost).
Administration Expenses
Selling and Distribution Expenses
} = Total Cost.

The Total Cost plus profit (or minus loss) gives the Selling Price.

Factory Overhead Charges include, *inter alia* :—

Rent and Rates.
Power {Coal, Gas, or Electricity,
Heating and Lighting,
} of Factory.
Repairs to Plant and Machinery and Factory Buildings.
Insurance of " " "
Depreciation of " " "
Factory Wages not chargeable direct, e.g., wages of storekeepers, foremen, and of labour in the boiler-house and engine-house.
Drawing Office Salaries and Expenses.

In dealing with the remaining indirect expenses it is usually advisable to distinguish between Administration Expenses (or Overheads) and Selling and Distribution Expenses (or Overheads), as follows :—

Administration Expenses.

Salary of General Manager.
Proportion of Office Salaries.
Expenses and Salaries of Directors.
Interest on Bank Overdraft, Loans, etc.
Proportion of Office Rent, Rates, Lighting, etc.

Selling and Distribution Expenses.

Proportion of Office Salaries and Expenses.
Proportion of Rent, Rates, Lighting, etc., of Office.
Advertising.
Travellers' Salaries and Expenses.
Commissions and Discounts.
Carriage Outwards.

It should be noted that some authorities favour the expression "Oncost" as an alternative to "Overheads."

Receipt and Storage of Materials.

In order to ensure the correct recording of the materials used on various jobs or processes, a sound system for the (1) purchase, (2) receipt, (3) inspection, (4) storage, and (5) issue of materials must first be installed. The precise routine to be adopted is dependent largely upon the type and size of the business concerned, but the details given below are typical of those employed in many works in this country.

In the first place, the purchase of goods is carried out through a Buying Department, which is notified by means of a Purchase Requisition from the Stores Department when the stock of any particular material is falling low and requires replenishment. When the new supply of material is delivered at the works, it is received by either the Storekeeper or the Goods Receiving Clerk, who examines the goods, checks the quantities, and enters full particulars of the delivery in duplicate on a Goods Received Note similar to the specimen shown below.

GOODS RECEIVED NOTE. No. 276.

Date.	Order No.	Suppliers.	Carriers.	Description of Goods.	Count or Volume.	Weight. t.	c.	q.	lbs.	Remarks as to Condition.
19.. July 1	875	R. Jones, Ltd.	C.P.	5″ Rings	100					O.K.

Bin No. 17. Stores Ledger Folio, 120. Storekeeper's Signature, R. J.

The original of the above note is then sent to the Buying Department, where it is compared with the supplier's Advice Note and Invoice. If these agree, the Invoice is then initialled and passed forward for payment.

After inspection, the goods, together with the duplicate Goods Received Note, are received into the Stores Department, which is laid out in a systematic and orderly manner, with a separate Bin or Rack, distinctively numbered and labelled, for each class of material. To each of these Bins or Racks a Bin Card is attached, on the lines of the following :—

BIN CARD.

BIN No. 17.
DESCRIPTION, 5″ RINGS.

MAXIMUM STOCK, 200.
MINIMUM STOCK, 50.
ORDERING LEVEL, 100.

RECEIPTS.			ISSUES.			BALANCES.
Date.	Goods Recd. Note No.	Quantity.	Date.	Stores Reqn. No.	Quantity.	Quantity.
19..			19..			
Jan. 1	87	200	Jan. 19	187	70	130
			June 10	476	75	55
July 1	276	100				155

At the time a consignment of material is placed in a bin, the quantity is recorded as a receipt on the Bin Card, the Bin Card number being correspondingly entered on the Goods Received Note. All receipts and issues of stock are similarly recorded, and after every transaction the new balance in hand is inserted in the " Balances " column on the extreme right of the above example. Thus, the balance as shown by the Bin Card should equal the quantity actually in stock at that time. The Maximum and Minimum Stock figures indicate the maximum and minimum quantities of the particular material which are considered necessary to satisfy the normal requirements of the works, while the Ordering Level indicates the stage at which further quantities should be ordered. When the balance shown by the Bin Card sinks to the ordering level, the Stores Department will, as already stated, notify the Buying Department.

After the Bin Card has been written up from the Goods Received Note the latter is then passed on to the Cost Office, where the particulars thereon are entered in the Stores Ledger. An account is kept therein for each class of material in stock, on the lines of the example on the next page :—

STORES LEDGER

Description, 5" Rings. Bin No. 17.	Stock checked by............ on........19.. ,, ... on........19.. ,, ... on........19..	Folio 120. Maximum Stock, 200. Minimum Stock, 50. Ordering Level, 100.

Receipts.								Issues.						
Date.	G.R. No.	Supplier.	Quantity.	Rate.	£	s.	d.	Date.	Reqn. No.	Quantity.	Rate.	£	s.	d.
19..								19..						
Jan. 1	87	R. Jones, Ltd.	200	1/-	10	0	0	Jan. 19	187	70	1/-	3	10	0
								June 10	476	75	1/-	3	15	0
July 1	276	,,	100	1/3	6	5	0							

If desired, columns may be inserted to record the balance of stock on hand after each receipt or issue.

In small works the Storekeeper may be in charge of both the Bin Cards and the Stores Ledger, but where the size of the works permits, it is preferable for the two records to be kept by different officials. In this way, the two records act as a check on each other and the Storekeeper is concerned with quantities only.

By means of these two records (Stores Ledger and Bin Cards) it is possible to arrive at the value of the stock at any date without actually taking stock. In practice, however, it is usual to carry out a continuous *Stores Audit* throughout the year. Under this system a Cost Office official actually counts, weighs or measures a certain number of items each day without previous notice to the Storekeeper as to which items he is going to check, and compares the balances thus ascertained with (i) the Bin Cards, and (ii) the Stores Ledger accounts. Any discrepancies should be closely investigated, a careful distinction being drawn between discrepancies which are (*a*) unavoidable, e.g., evaporation or loss in breaking up bulk material, and (*b*) avoidable, e.g., pilferage, or incorrect calculation of Bin Card balances. After investigation, the book stock should be adjusted to the actual stock by crediting the Bin Card and Stores Ledger Account and debiting Stock Adjustment Account, the balance on which will be included in Factory Overhead Charges. Where a surplus is revealed these entries are reversed.

Issue of Materials.

There should be a strict rule that materials may only be issued from stores upon the presentation of a properly authorised Stores (or Materials) Requisition, as shown in the following illustration :—

No. 187. STORES REQUISITION.

Date, 19th Jan., 19.. Dept. No. 2. Job No. 18B.

Description of Material.	Count or Volume.	Weight. t.	c.	q.	lbs.	Rate.	£	s.	d.
5″ Rings	70					1/-	3	10	0

Authorised by A. B. Supplied from Bin No. 17.
Materials received by C. D. Storekeeper's Signature, R. J.
Entered : Bin Card..*R. J.*..Stores Ledger..*G. H.*..Job..*X. Y.*

Requisitions for materials to be used on jobs are usually authorised by the foreman concerned, and taken to the stores by a workman, who signs and surrenders the Requisition in return for the material. The storekeeper then enters the goods issued in the "Issues" column of the appropriate Bin Card (see specimen on page 651), and signifies this fact in the space provided on the Stores Requisition. If all the stores required are not available, the requisition will be amended accordingly and initialled by the storekeeper.

Where the storekeeper is concerned with the Bin Cards only, he then passes on the Stores Requisition to the Cost Office, where the money values of the stores issued are inserted prior to posting the issues, (i) to the credit of the Stores Ledger accounts concerned, and (ii) to the debit of the jobs or processes on which they were used.

When materials used are purchased specially for a job, they are charged thereto at the net invoice price, plus delivery charges to the works, but where issues are made from general stores, purchased at different times and at different prices, the necessary pricing is sometimes a difficult matter. The principal methods used in practice are :—

(1) The Average Price Method. Under this method the cost price is averaged periodically, say, monthly,

and all stores issued during the ensuing month are charged out at this average price, e.g. :—

		£	s.	d.
Stock on hand (1st March) .	100 at 2s. 0d.	10	0	0
Deduct: Issues during March .	60 at 2s. 0d.	6	0	0
	40 at 2s. 0d.	4	0	0
Add: Purchases during March	40 at 2s. 6d.	5	0	0
	80	£9	0	0

$\therefore$ Average Price$=\frac{180s.}{80}=$2s. 3d., the price at which issues during the month of April will be charged.

(2) THE "FIRST-IN, FIRST-OUT" METHOD. Under this method, the first issue is deemed to have been made from the oldest stock, and so on. Thus, if the stock consists of 50 lbs. bought at 1s. 0d. and 60 lbs. subsequently bought at 10d., then the first 50 lbs. issued will be charged out at 1s. 0d. and the next 60 lbs. at 10d. This method may be inequitable when a job is charged with materials at one price and another job is charged at a different price, even though the second issue may be made immediately after the first.

(3) A FIXED PRICE. When changes in price are rare, it may be possible to charge out materials at a fixed price (periodically reviewed and, if necessary, altered), this method having the advantage of simplicity.

The next step, after crediting the appropriate Stores Ledger accounts, is to debit the job, contract, etc., on which the materials were used. Each job or contract undertaken may be allotted a number (known as its Job Number or Contract Number), which will appear on all instructions regarding the job, on all Stores Requisitions and other forms used in connection with it, and on the cost sheet or card on which the cost of the particular job is collected. Periodically, say, weekly or monthly, the Stores Requisitions are sorted out in the Cost Office under Job Numbers, and summarised on a Materials Abstract in analysis form (see page 655), separate columns being used for each contract, process, etc. The total materials used on each contract will then be debited to the particular contract account and credited to the Stores Account in the cost ledger. This latter account acts as a control account for the Stores Ledger, on the lines of the Adjustment Accounts used under the self-balancing system. Thus, the credit to the above-mentioned Stores Account for a certain period equals *in total* the individual issues credited *in detail* in the Stores Ledger.

After completion of the work, surplus materials (if any) are returned to the stores together with a Stores (or Materials) Credit

Note. These Credit Notes are analysed in the Materials Abstract in the same way as the requisitions, but *in red ink.* The totals of the Stores Credit Notes are credited to the respective contract or job accounts and debited to the Stores Account, or, alternatively, only the balance of the Materials Abstract will be posted. In addition, individual debit entries are made in the Stores Ledger accounts affected, and the materials returned are also shown as receipts on the Bin Cards.

Sometimes, instead of returning surplus materials to stores, it is more convenient to transfer them direct to another job, though this is not advisable unless the cost of returning the materials to store is prohibitive, as an accurate check cannot always be kept on such goods, and one job may not receive the correct debit and the other job the correct credit for the materials transferred between them. Where transfers cannot be avoided a Stores (or Materials) Transfer Note is made out, giving particulars of the materials transferred and the Job Numbers of the jobs concerned. These Transfer Notes are shown on the Materials Abstract as a deduction from the transferor jobs and an addition to the transferee jobs. The Stores Account is *not* affected.

MATERIALS ABSTRACT.

FOR WEEK ENDING 7TH DECEMBER, 19..

Contract No. 230		Contract No. 231		Contract No. 232		Contract No. 233		Contract No. 234		Contract No. 235		Other Columns as required.	Summary.
Req. No.	£ s. d.	Req. No.	£ s. d.	Req. No.	£ s. d.	Req. No.	£ s. d.	Req. No.	£ s. d.	Req. No.	£ s. d.		£ s. d.
59	1 17 6	64	15 0	63	7 3 8	60	17 8	62	12 8	61	8 0		
68	5 0	66	2 6					65	1 3 6				
								67	4 0				
	£2 2 6		£ 17 6		£7 3 8		£ 17 8		£2 0 2		£ 8 0		£13 9 6

The total of each column is debited to the individual contract accounts, and the figure in the total column is credited to Stores Account. There are no credits or transfers in this example.

The following illustration shows a typical ruling of a Contract or Job Account :—

Dr. JOB OR CONTRACT NO. .... NAME .... *Cr*

Date.	Details.	Ref.	Direct Purchases.	Ref.	Materials from Stores.	Ref.	Wages.	Ref.	Direct Expenses.	TOTAL.	Date.	Details.	Ref.	AMOUNT.

The factory and office overhead expenses will in this case be shown as additions in the total column, but in many cases additional columns are reserved on the debit side for these items.

The significance of the remaining columns in this account will be more fully explained later in this chapter.

In some cases it is desirable to show particulars of the materials used on each contract, in addition to the values. If this is to be done, the Materials Abstract cannot be used, and it is necessary to post the requisitions and credit notes either direct from the slips themselves or from a Stores Received and Stores Issued Book, the details of each item being shown in the contract accounts and the total posted to Stores Account as before; or, where separate accounts are kept for each class of material, the total must be analysed under the various headings and posted to the appropriate material accounts.

Direct Wages.

The recording of direct wages in cost accounts involves the following features :—

(1) A record must be kept of the time spent by each man *inside the works*, in order to ascertain the wages due to him. This may be done by either of the following systems :—

(*a*) By means of checks or tallies which are removed from a board and dropped into a box on entering and leaving the works, late comers and absentees being noted from the tallies still remaining on the board. This system is liable to lead to disputes as to times of arrival and departure, and is liable to be abused by unscrupulous workers, who may remove the tallies of other workers who have not arrived.

(*b*) By means of time-recording machines which automatically record the time of arrival or departure when the worker inserts his time card and depresses a lever. An illustration of such a card is given on page 657.

(2) A record must also be kept of the time spent by each man *on each job*. The ways of doing this vary according to the size of the works and the nature of the industry concerned. An illustration is given on page 658 of a daily Time Sheet, on which the worker records the time spent on each job during the day. Another widely used method is to employ a separate Job Card for each job operated upon by the worker; and to note on the card, either by hand or mechanically, the times of commencing and finishing the job.

Separate cards are made out for "idle" or "waiting" time. In other cases, the foremen are supplied with record sheets or books for each workman, upon which particulars of the time spent on the various jobs, etc., are entered. If wages are paid according to the amount of work produced, i.e., on a piece-work basis, a piece-work ticket will be used containing particulars of the number of articles produced, the rate per piece, and the initials of the viewer.

(3) Each week the total time on the job cards for each man is agreed with his time as shown by his time card, taking into consideration any "waiting" or "idle" time. The time cards are then passed to the Wages Office for the purpose of preparing wages.

(4) The total wages paid must be summarised, and for this purpose a Wages Abstract may be prepared from the job cards, similar in form to the Materials Abstract on page 655. The total direct wages thus ascertained are credited to Wages Account in the cost ledger, while the analysed details are posted to the debit of the particular contract or job accounts.

TIME CARD.

No...............

Name.... ....

Week Ending.................

Day.	IN.	OUT.	IN.	OUT.	Total.
A.M. F. P.M.					
A.M. S. P.M.					
A.M. Sun. P.M.					
A.M. M. P.M.					
A.M. T. P.M.					
A.M. W. P.M.					
A.M. Th. P.M.					

OBVERSE]

No...........

Name.........................

THIS SIDE OUT.

Hold Card whilst recording time.

HOURS WORKED.	ORDINARY WAGE.		
hours at ordinary time ...			
... hours at 1¼ time ...			
hours at double time ...			
PLUS PREMIUM BONUS ...			
LESS INSURANCE — ...			
LESS INCOME TAX			
TOTAL AMOUNT PAID £			

REVERSE]

TIME SHEET.

Number of Employee................ Date................

Name of Employee.................. Trade...............

Job No.	Name of Customer.	Particulars of Work Done.	Time.		Total.	Rate.	£ s. d.
			Commence.	Finish.			
	In large concerns this column is omitted, the workmen not being allowed to know the names of the firm's customers.						

Signed...........................

Foreman.

Methods of Remuneration.

A satisfactory system of remuneration must be devised which will ensure a fair remuneration to the employee in return for the maximum output. The principal methods of remuneration are as follows :—

(1) TIME RATE, under which the worker is paid a fixed amount per hour, day, or week. This method is suitable where delicate and fine quality work, or unskilled labouring work, is performed, but in other cases it is usually unsatisfactory, as it rewards all workers, good and bad, alike, and offers no incentive to the keen worker to turn out more than an average output.

(2) PIECE RATE, under which the worker is paid a fixed amount for each job, article or operation, regardless of the time taken. Provided that there is a strict system of inspection to guard against scamped work, the employer is rewarded by an increased output and the employee by an increased remuneration.

Accurate fixing of piece rates is essential, for if the rates are too low the worker cannot earn a fair wage, while if they are too high, he will obtain excessive earnings. This may tempt the management to " cut " the rate, and thus produce ill-feeling among the workers. No incentive is given to the workers to work extremely hard and any attempt to reduce the rate when times are bad meets with considerable opposition.

(3) Premium Bonus. There are many premium bonus methods, but the underlying principle is the same in all cases—the sharing between employer and employee, in some proportion, of the time saved in performing a job or operation as compared with the standard time fixed for that job. In this way it is possible to offer an incentive to the worker in cases where an accurate piece rate cannot be fixed. The principal premium bonus methods are :—

(a) *The Halsey-Weir Method.*—Under this method the worker is paid a bonus calculated as a percentage of the time *saved* as compared with the standard time fixed for the job. Thus, if a worker whose hourly rate is 2s. completes in 8 hours a job for which the time allowance is 10 hours, he is paid at 2s. per hour for the time taken, and if he is to be paid a bonus of 50 per cent. of the time saved, he will receive additional payment for one hour at 2s., making his total wages for the job 18s.

(b) *The Rowan Method.*—A standard time is also fixed under this method, but the worker is paid for the time taken at his hourly rate plus a percentage based on the time saved in proportion to the time *allowed*. Assuming the same figures as in the previous example, the worker, having saved 20 per cent. of the time allowed, will receive 8 hours' wages at 2s. plus 20 per cent. of 2s., or 8 hours at 2s. $4\frac{4}{5}$d.=19s. 2d. (approximately).

Direct Expenses.

Expenses directly chargeable to contracts are notified to the cost office by the general office, and are then debited to the particular contract account and credited to a Direct Expenses Account in the cost ledger. Every possible expense that can

be analysed and charged as Direct Expenses should be so treated, rather than grouped as General Expenses. In the same way materials and wages should, as far as practicable, be charged direct to specific contracts or jobs.

Factory Overhead Charges.

All the items comprising the "Prime Cost" having been dealt with, the Factory Overhead Charges, consisting of Indirect Materials, Labour and Factory Expenses, have now to be apportioned over the processes, contracts, jobs, etc., in such a way that each job, etc., bears an equitable share of the overhead charges attachable thereto. It should be remembered that it is not possible to ascertain the exact amount of these indirect expenses until the periodical financial accounts are drawn up. Consequently, the amount to be charged (sometimes termed "Oncost") is merely an *estimated* provision based on past experience and adjusted to meet present circumstances.

The *actual* indirect expenses are included in the nominal accounts in the financial books, and it is the works portion of these expenses which is included in the general heading *Factory Overhead Charges* (or Factory Oncost).

The methods adopted in allocating this portion of the indirect expenses vary according to circumstances, but the following are the principal :—

1. PERCENTAGE ON PRIME COST. Each job is charged with an amount which bears the same relation to the prime cost of that job as the total indirect expenses bear to the total prime cost of all the jobs, the total works expense for a given former period $\times$ 100 being divided by the total prime cost for the same period to give the rate per cent.

EXAMPLE.

	£
Direct Wages	40,000
Direct Materials . . .	50,000
Direct Charges . . .	10,000
Prime Cost . . .	£100,000
Factory Overhead Charges .	£20,000

If Factory Overhead Charges are to be recovered as a percentage of prime cost, there must be added to the prime cost of each job :—

$$\frac{20,000}{100,000} \times 100 = 20\%.$$

This method is simple to apply, but it usually gives inaccurate results, as in the majority of cases no definite relationship exists between factory expenses and prime cost figures. It may be

applied fairly safely where the products of the concern are more or less similar, and where direct labour and direct materials are in the same ratio to each other for every job.

2. Percentage on Direct Wages. This is applied in the same manner as the previous method, except that in this case the percentage is calculated on the direct wages incurred on the job. Thus, assuming the same figures as in the previous example, a sum equal to 50 per cent. of the direct wages would be added to the prime cost of each job to cover factory overhead charges.

This is a satisfactory method when rates of wages are fairly even and there are no expensive machines and equipment; but where different rates of wages are in force it tends to overcharge work done by highly skilled (and hence highly paid) men and undercharge work done by unskilled labour.

3. Flat Hourly Rate on Direct Wages. The basis for this method is the total number of hours worked by the employees on the job, process, contract, etc., and the expenditure is charged at a flat rate per hour obtained in the following manner. A calculation is made of the total number of hours worked by the productive employees during a given period, and the total indirect expenditure for that period is divided by the total number of hours, thus yielding the required flat hourly rate.

This method is, on the whole, more logical than the two previous methods, since it is based on *time*, and many expenses (e.g., rent, rates and insurance) vary in proportion to time and not in proportion to prime cost or direct wages. It cannot be used where different departments employ machines and equipment of widely different capital values and running costs, since it overcharges hand labour employing inexpensive equipment, and undercharges labour using expensive machinery. This difficulty is sometimes overcome by employing a series of Hourly Rates on Classes of Labour.

4. Machine Hourly Rate. This method is similar to the productive hourly rate, the basis of charge being the number of hours the machinery is employed on the job, process or contract. Each machine, or group of similar machines, should be treated separately, as the hourly costs of running the various machines or groups of machines may differ considerably.

In many cases this method is adopted to cover only those expenses which are directly related to the machine, e.g., wear and tear, repairs and maintenance charges of the machinery. Other departmental expenses, such as rent, rates, lighting and indirect wages, are allocated on a different basis (e.g., by means

of a percentage on direct wages). Sometimes, however, the *whole* of the departmental expenses are included in the machine hourly rate, in which case *each group of similar machines is treated as a separate department*, the expenses being allocated as follows :—

(a) *Rent, Rates, Heat and Light*—in proportion to the area or cubic capacity occupied. The different rental values of different storeys should, however, be considered when allocating rent and rates, and whether some storeys are continuously lighted, when allocating lighting.

(b) *Power*—actual consumption determined by h.p. of machines or by meter readings.

(c) *Repairs*—actual expenditure according to the records from the Cost Office.

(d) *Tools*—actual consumption per tool-room requisitions.

(e) *Sundry Stores*—actual consumption as shown by the stores requisitions.

(f) *Depreciation*—calculated separately for each department or group.

(g) *Indirect Wages and General Works Services*, e.g., storekeepers, cranemen, etc.—in proportion to total direct wages in each operating department.

(h) *Fire Insurance*—proportionate to values of buildings and plant in each department.

(i) *Workmen's Compensation Insurance*—from the detailed schedule attached to the insurance policy.

(j) *National Insurance*—obtained from the Wages Book, in which each department would have a separate section.

(k) *Works Management Salaries and Works Clerical Salaries*—proportionate to the wages in operating departments.

The following statement shows the allocation of the total expenses for four weeks over three departments adopting the machine hour rate method :—

WORKS EXPENSE ALLOCATION.

ACCOUNT.	Total for 4 weeks. Adjusted as to outstanding items.	No. 1 Shop.	No. 2 Shop.	No. 3 Shop.	General Factory Service.
	£	£	£	£	£
1. Rent and Rates	600	100	200	250	50
2. Electric Power	500	50	100	300	50
2. Coal and Gas	200	50	100	20	30
3. Depreciation	600	100	200	300	..
3. Repairs to Buildings and Plant	750	75	150	450	75
3. Tools	100	20	30	50	..
2. Sundry Stores—Oil, etc.	150	25	25	100	..
3. Sundry Labour	1,000	100	300	400	200
3. Storekeeping	250	50	100	100	..
3. Superintendence	350	100	100	150	..
3. Employers' Liability and State Insurance	85	15	20	40	10
	£4,585	685	1,325	2,160	415
General Factory Service £415 (This may fairly be allocated on the basis of productive wages in each shop.)		85	110	220	
		£770	£1,435	£2,380	
		Total £4,585			

1. Based on space occupied. 2. Based on engineer's estimate.
3. Based on actual outlay.

Assuming that all the machines in No. 1 Shop are of the same type, and that the estimated number of working hours for the four-weekly periods is 3,080, then the hourly cost of running the machines in No. 1 Shop is $\frac{770}{3{,}080} = 5s.\ 0d.$, and a charge of 5s. 0d. would be made for every hour during which a job was being worked upon by the machines in the shop. Where, however, machines of widely different capital values and running costs are included in the same department, a separate machine hour rate should be fixed for each group of similar machines, or even for each individual machine. In such an event, the total expenses of No. 1 Shop (£770) will be apportioned over the machines contained therein on exactly the same lines as the total expenses were allocated over the three shops in the above Allocation Statement.

5. A Fixed Amount per Unit or Article Produced. This method may be used where a single or a limited variety of articles is produced on mass production lines.

EXAMPLE.

The total direct wages for a period amounted to £10,500 and the total factory overhead charges for the same period amounted to £5,250.

Assuming that the "Percentage on Direct Wages" method is used, a charge

of 50 per cent. will cover the whole of the factory charges. The cost finding on a job to date will be as follows:—

	£	
JOB OR CONTRACT NO.		
Direct Materials	575	
„ Wages	186	
„ Expenses	23	
	784	*Prime Cost.*
Add 50 per cent. on Direct Wages to cover factory charges	93	
	£877	*Factory (or Works) Cost.*

To arrive at the total cost of this job it is then necessary to add a proportion of selling and administrative expenses.

Selling and Administration Expenses. The items included under this heading are enumerated on page 649. To make the example clear, it will be assumed that these are to be treated as one charge. Unless the industry is one in which selling and administration expenses are heavy, it will usually be found that they can be fairly accurately covered by a percentage on the works cost. To complete the cost finding, therefore, a percentage, say 10 per cent., will be added thus:—

	£	
Factory (or Works) Cost	877	
Add for selling and administration expenses 10 per cent. on factory cost	88	
	£965	*Total Cost.*

The total cost of the contract or job is £965, and any amount received in excess of this will be the profit on the contract.

The individual items for these establishment charges will be debited to each contract or job account, and to complete the double entry the same amounts will be credited to an Establishment Charges (or Oncost) Account in the cost ledger.

Work-in-Progress.

This is the name given to uncompleted work on hand at any time. Its value is arrived at in the cost accounts by taking out the balances of uncompleted jobs in the Job Ledger, and adding to each an appropriate amount in respect of overhead charges. As a rule, however, overhead charges are not debited to a job account until the job is completed. Consequently, when accounts are prepared at the end of a trading period, the charge for overhead charges on work-in-progress is credited to Overhead Charges Account in the cost ledger, and is debited to an Overhead Charges Suspense Account,—*not* to the particular contract account. At the opening of the next period these entries are reversed, the

Suspense Account being credited and the Overhead Charges Account debited.

This plan cannot, however, be followed out when there are numerous rates in use ; then the correct oncost must be obtained from the wages abstract details, or shown on the wages notes and summarised similarly to the summarising of wages and posted to the Cost Ledger Accounts week by week.

In valuing work in progress it is usually undesirable to include any profit on the work to date, unless the job is in a very advanced state, since it cannot be known whether the expenditure to be incurred will result in less profit being made than was anticipated or even the incurring of a loss.

Any loss which has been incurred to date, or any loss which it is known will be incurred in the future should, however, be adequately reserved for.

In the case of long contracts extending over a number of years, however, it is permissible to add a fair profit. If this were not done in the case of a public company it might result in the company being unable to pay dividends on its capital in those years when few contracts were completed. The profits of the company might fluctuate widely from one year to another, causing the Stock Exchange quotations of the company's shares to fluctuate also, and generally acting to the detriment of the company.

This disadvantage might be overcome by building up, in those years in which large contracts were completed and the profits thereon realised, a reserve for the equalisation of dividends in lean years (see page 332), but it is more usual to estimate at the close of each accounting period, the profit which has been made to date on all contracts which are in a reasonably advanced state.

A very conservative estimate should be made, and usually only two-thirds of the profit earned on the *value of the work completed* to date, as certified by the architect, should be credited to Profit and Loss Account.

A further reserve is advisable in respect of any unpaid portion of work done and certified (e.g., where, under the terms of the contract, a certain proportion of each sum certified by the architect is not paid immediately, but is retained until the completion of the contract, i.e., retention money), and full provision should be made for any probable contingencies, e.g., strikes, rise in price of raw materials, etc.

EXAMPLE.

On 1st April, 1940, Public Contractors Limited commenced to build a new Town Hall, the contract price being £400,000. The company's financial year ended on 30th September, 1940, on which date the following expenditure had been incurred in connection with the contract:—

	£
Materials	60,000
Wages	42,000
Plant	10,000
Overhead Charges	3,000

Work to the value of £120,000 had been certified on 30th September, 1940, of which 75 per cent. had been received in cash. Work completed but not certified was estimated at £10,500, and materials valued at £5,000 were on hand at the site.

After allowing for depreciation at the rate of 10 per cent. per annum on Plant, prepare an account showing the profit earned to date, and the amount of profit for which the company may take credit in its accounts to 30th September, 1940.

Dr. CONTRACT ACCOUNT. *Cr.*

Job No.........

TOWN HALL FOR ....CORPORATION.

Contract Price, £400,000.

1940			£	1940			£
April to Sept.	To Materials		60,000	April to Sept.	By Work Certified		120,000
	„ Wages		42,000	Sept. 30	„ Work in Progress	*c/d.*	10,500
	„ Plant		10,000		„ Plant [see Note 1]	*c/d.*	9,500
	„ Overhead Charges		3,000		„ Materials on Hand	*c/d.*	5,000
Sept. 30	„ Net Profit:— Transferred to P. & L. A/c. [see Note 2]		15,000				
	Balance	*c/d.*	15,000				
			£145,000				£145,000
Oct. 1	To Work in Progress	*b/d.*	10,500	Oct. 1	By Balance	*b/d.*	15,000
	„ Plant	*b/d.*	9,500				
	„ Materials on Hand	*b/d.*	5,000				

NOTES.—(1) The value of the plant carried down on 30th September is computed by deducting 10 per cent. depreciation for six months from the cost of the plant debited in the account.

(2) On balancing the account, a profit of £30,000 is disclosed, of which two-thirds (£20,000) might be credited to Profit and Loss Account. As, however, only 75 per cent. of the work certified has been received in cash, only £15,000 (i.e., 75 per cent. of £20,000) should be credited to Profit and Loss Account, the balance being carried forward as a reserve.

DOUBLE ENTRY COST ACCOUNTING

In the foregoing pages the treatment of the various items comprised in the total cost of a job, article or process have been dealt with. It is now necessary to consider how the double entry is carried out in respect of every entry in the costing records.

In the first place, it is highly advisable for the cost accounts to be kept on complete double entry lines, in order to ensure the arithmetical accuracy of the entries therein. The number of books of account used will vary according to the size and nature of the concern, but the following are usually employed :—

(1) STORES LEDGER. The use of this ledger has already been described, and reference should again be made to the specimen Stores Ledger account appearing on page 652. If all entries have been correctly made in this ledger, the total balances at any date will represent the value of the stock in hand on that date.

(2) STOCK LEDGER. This is similar to the Stores Ledger, and records details of the finished stock produced. The accounts are debited with finished stock, at cost price (the corresponding job accounts being credited), and credited with all goods sold from stock. The total balances on this ledger at any date equal the cost of the finished stock in hand on that date.

(3) JOB (OR CONTRACT) LEDGER. The manner in which this ledger is written up has already been described, and reference should be made to the specimen ledger account on page 655. When the job or contract is completed, it is transferred :—

 (i) If for stock, to the debit of a Finished Stock Account.

 (ii) If a definite contract, to a Completed Contracts Account, which is credited with the agreed contract price, in order to show the profit or loss on the contract.

(4) COST LEDGER. This ledger controls the whole of the costing system and its contents must be noted with great care. Separate control accounts are opened for Stores, Work-in-Progress, and Finished Stock, their function being similar to that of the adjustment accounts opened in the general ledger when it is required to make the sales or purchases ledgers self-balancing. For example, the Stores Control Account, which is kept in the Cost Ledger, contains *in total* the whole of the items appearing in the Stores Ledger accounts *in detail*, so that on a given date the balance on the Stores Control Account is equal to the total balances in the Stores Ledger. In the same way, the Work-in-Progress Account and the Finished Stock Control Account serve as control accounts for the Job Ledger and Stock Ledger respectively.

Finally, in order to render the Cost Ledger self-balancing, and to serve as the connecting link between the cost and financial accounts, a *Cost Ledger Control Account* (or General Ledger Adjustment Account, as it is alternatively termed) is opened in the Cost Ledger, and is debited and credited with all items appearing in the cost accounts which have their origin in the financial accounts. It is also credited or debited with the profit or loss appearing in the costing records, which, as indicated later, is not necessarily the same as that disclosed by the financial records.

The following example shows the usual accounts appearing in the Cost Ledger of a manufacturing concern.

EXAMPLE.

The following Trial Balance is extracted from the Cost Ledger of the A.B.C. Manufacturing Co., Ltd., as at 1st January, 19.. :—

	Dr.	*Cr.*
	£	£
Stores Control Account	5,000	
Work-in-Progress Account	4,500	
Finished Stock Control Account	2,500	
Works Overhead Charges Suspense Account	1,000	
Office Overhead Charges Suspense Account	200	
Cost Ledger Control Account		13,200
	£13,200	£13,200

The following is a list of the transactions which have taken place during the year to 31st December, 19.. :—

	£
Stores purchased	12,500
Carriage inwards on stores purchased	250
Wages paid (Direct, £7,000; Indirect, £1,500)	8,500
Works Overhead Charges paid	2,250
Office Overhead Charges paid	780
Selling and Distribution Expenses paid	2,000
Direct Expenses	750
Materials used on jobs	12,600
Indirect materials used	350
Works Overhead Charges allocated to completed jobs	4,200
Do. do. Work-in-Progress	900
Office Overhead Charges allocated to completed jobs	825
Do. do. Work-in-Progress	175
Finished Stock completed during year—at cost	15,350
Contracts completed during year—at cost	10,525
Do. do. —at contract prices	11,750
Finished Stock sold during year—at sale prices	19,320
Do. do. —at cost	15,100
Selling and Distribution Expenses allocated	2,040

In addition the following totals have been compiled at 31st December, 19.., from the detailed balances in the Stores, Job and Stock Ledgers:—

	£
Stores (checked by actual stock-taking)	4,750
Finished Stock (Do.)	2,750
Work-in-Progress	4,000

From the foregoing particulars, write up the Cost Ledger of the A.B.C. Manufacturing Co., Ltd., for the year ended 31st December, 19.., and extract a Trial Balance as at that date.

Dr. STORES CONTROL ACCOUNT. *Cr.*

		£			£
19..			19..		
Jan. 1	To Balance *b/d.*	5,000	Dec. 31	By Work-in-Progress A/c., materials used on jobs	12,600
Dec. 31	,, Cost Ledger Control A/c., stores purchased	12,500	,,	,, Works Overhead Charges A/c., indirect materials used	350
,,	,, Do., Carriage inwards on stores purchased	250	,,	,, Do., Difference on Stores A/cs. written off	50
			,,	,, Balance *c/d.*	4,750
		£17,750			£17,750
19..					
Jan. 1	To Balance *b/d.*	4,750			

Dr. WORK-IN-PROGRESS ACCOUNT. *Cr.*

		£			£
19..			19..		
Jan. 1	To Balance *b/d.*	4,500	Dec. 31	By Finished Stock Control A/c., stock finished during year	15,350
Dec. 31	,, Stores Control A/c., materials used on jobs	12,600	,,	,, Completed Contracts A/c., Contracts completed during year	10,525
,,	,, Wages Control A/c., direct wages incurred	7,000	,,	,, Balance *c/d.*	4,000
,,	,, Cost Ledger Control A/c., direct expenses	750			
,,	,, Works Overhead Charges A/c.	4,200			
,,	,, Office, Do.	825			
		£29,875			£29,875
19..					
Jan. 1	To Balance *b/d.*	4,000			

Dr. FINISHED STOCK CONTROL ACCOUNT. *Cr.*

		£			£
19..			19..		
Jan. 1	To Balance *b/d.*	2,500	Dec. 31	By Cost of Sales A/c., finished stock sold during year	15,100
Dec. 31	,, Work-in-Progress A/c., finished goods passed into stock during year	15,350	,,	,, Balance *c/d.*	2,750
		£17,850			£17,850
19..					
Jan. 1	To Balance *b/d.*	2,750			

Dr. WORKS OVERHEAD CHARGES SUSPENSE ACCOUNT. *Cr.*

		£			£
19..			19..		
Jan. 1	To Balance *b/d.*	1,000	Jan. 1	By Works Overhead Charges A/c.	1,000
Dec. 31	To Works Overhead Charges A/c.	900	Dec. 31	By Balance *c/d.*	900
19..					
Jan. 1	To Balance *b/d.*	900			

Dr. OFFICE OVERHEAD CHARGES SUSPENSE ACCOUNT. Cr.

19..		£	19..		£
Jan. 1	To Balance *b/d*. . . .	200	Jan. 1	By Office Overhead Charges A/c.	200
Dec. 31	To Office Overhead Charges A/c.	175	Dec. 31	By Balance *c/d*. . . .	175
19..					
Jan. 1	To Balance *b/d*. . . .	175			

Dr. WORKS OVERHEAD CHARGES ACCOUNT. Cr.

19..		£	19..		£
Jan. 1	To Works Overhead Charges Suspense A/c. . .	1,000	Dec. 31	By Work-in-Progress A/c., charges made against completed jobs or contracts . . .	4,200
Dec. 31	,, Wages Control A/c., indirect wages incurred .	1,500	,,	,, Works Overhead Charges Suspense A/c., charges made against uncompleted jobs or contracts	900
,,	,, Cost Ledger Control A/c., expenses for year .	2,250	,,	,, Costing Profit and Loss A/c., under-allocation of overhead charges .	50
,,	,, Stores Control A/c., indirect materials used .	350			
,,	,, Do., difference in stocks .	50			
		£5,150			£5,150

Dr. OFFICE OVERHEAD CHARGES ACCOUNT. Cr.

19..		£	19..		£
Jan. 1	To Office Overhead Charges Suspense A/c. . .	200	Dec. 31	By Work-in-Progress A/c., charges made against completed jobs or contracts . . .	825
Dec. 31	,, Cost Ledger Control A/c., expenses for year .	780	,,	,, Office Overhead Charges Suspense A/c., charges made against uncompleted jobs or contracts	175
,,	,, Costing Profit and Loss A/c., over-allocation of overhead charges .	20			
		£1,000			£1,000

Dr. SELLING AND DISTRIBUTION EXPENSES ACCOUNT. Cr.

19..		£	19..		£
Dec. 31	To Cost Ledger Control A/c., selling, etc., expenses for the year . .	2,000	Dec. 31	By Cost of Sales A/c., selling and distribution expenses charged during the year . . .	2,040
,,	,, Costing Profit and Loss A/c., over-allocation of overhead charges .	40			
		£2,040			£2,040

Dr. WAGES CONTROL ACCOUNT. *Cr.*

19..		£	19..		£
Dec. 31	To Cost Ledger Control A/c., wages for the year .	8,500	Dec. 31	By Work-in-Progress A/c., wages incurred on jobs and contracts . .	7,000
			,,	,, Works Overhead Charges, A/c.	1,500
		£8,500			£8,500

Dr. COMPLETED CONTRACTS ACCOUNT. *Cr.*

19..		£	19..		£
Dec. 31	To Work-in-Progress A/c., contracts completed during year . .	10,525	Dec. 31	By Cost Ledger Control A/c., contract prices of contracts completed during year	11,750
,,	,, Costing Profit and Loss A/c., profit for year .	1,225			
		£11,750			£11,750

Dr. COST OF SALES ACCOUNT. *Cr.*

19..		£	19..		£
Dec. 31	To Finished Stock Control A/c., finished stock sold during year . .	15,100	Dec. 31	By Cost Ledger Control A/c., sales for year at sale prices . . .	19,320
,,	,, Selling and Distribution Expenses A/c., charges made during year .	2,040			
,,	,, Costing Profit and Loss A/c., profit for year .	2,180			
		£19,320			£19,320

Dr. COSTING PROFIT AND LOSS ACCOUNT. *Cr.*

19..		£	19..		£
Dec. 31	To Works Overhead Charges A/c., amount under-allocated during year .	50	Dec. 31	By Completed Contracts A/c., profit on contracts completed during the year	1,225
,,	,, Cost Ledger Control A/c., net profit transferred .	3,415	,,	,, Cost of Sales A/c., profit on finished stock sold during the year . .	2,180
			,,	,, Office Overhead Charges A/c., amount over-allocated during year .	20
			,,	,, Selling and Distribution Expenses A/c., amount over-allocated during year	40
		£3,465			£3,465

Dr. COST LEDGER CONTROL ACCOUNT. *Cr.*

19..		£	19..		£
Dec. 31	To Cost of Sales A/c., sale price of finished stock sold during year . .	19,320	Jan. 1	By Balance *b/d.* . . .	13,200
,,	,, Completed Contracts A/c., contract prices of contracts completed during year	11,750	Dec. 31	,, Stores Control A/c., stores purchased . . .	12,500
,,	,, Balance *c/d.* . . .	12,575	,,	,, Do., carriage inwards on stores purchased. .	250
			,,	,, Wages Control A/c., wages paid as per pay-roll for year	8,500
			,,	,, Works Overhead Charges A/c., expenses for year	2,250
			,,	,, Office Overhead Charges A/c., expenses for year	780
			,,	,, Selling and Distribution Expenses A/c., expenses for year . . .	2,000
			,,	,, Work-in-Progress A/c., direct expenses . .	750
			,,	,, Costing Profit and Loss A/c., net profit for the year	3,415
		£43,645			£43,645
			19..		
			Jan. 1	By Balance *b/d.* . . .	12,575

TRIAL BALANCE

AS AT 31ST DECEMBER, 19..

	Dr.	*Cr.*
	£	£
Stores Control Account	4,750	
Work-in-Progress Account	4,000	
Finished Stock Control Account	2,750	
Works Overhead Charges Suspense Account . .	900	
Office Overhead Charges Suspense Account . .	175	
Cost Ledger Control Account		12,575
	£12,575	£12,575

NOTES.

(1) On writing up the Stores Control Account a difference of £50 is revealed. In the absence of further information it is assumed that the book values in the Stores Ledger were found to be £50 in excess of the actual values as revealed by the stock-taking, and that they have been adjusted to the actual values. Consequently the Stores Control Account in the Cost Ledger must be similarly adjusted to make the balance on this account equal to the detailed balances in the Stores Ledger. This is done by transferring the shortage to the debit of Works Overhead Charges Account, since it represents, in effect, an additional indirect expense. [If, however, the shortage were of an abnormal nature, it would be preferable to transfer it to the debit of Costing Profit and Loss Account.]

(2) Separate Work-in-Progress Accounts could be opened in respect of special contracts undertaken, and articles manufactured for stock. There is not, however, sufficient information to enable this to be done in the present example.

(3) Stocks of finished goods include an equitable proportion of works and office overhead charges, but *not* selling and distribution expenses, as these are attachable only to stock which has actually been sold.

(4) It is assumed that the contracts undertaken do not extend over a very lengthy period, and the question of estimated profit on uncompleted contracts has therefore been ignored.

Agreement of Cost and Financial Accounts.

As stated on page 645, it is desirable that the results shown in the cost accounts should agree with those shown in the financial books, and it is now necessary to consider how this is accomplished. For various reasons the two profits rarely agree at the outset. Certain items, such as materials specially purchased for certain jobs, and direct expenses and wages, should agree exactly, but in other directions differences are almost inevitable. For example :—

(1) Closing Stocks may be valued on different bases in the two sets of accounts. Thus, stocks of raw materials are normally valued at "cost, or current market price, if lower" in the financial accounts, but may be retained at cost in the cost accounts, although the market value may have fallen.

(2) The charges made in the cost accounts for overhead charges are based on the expenses and production of a previous period, adjusted to the estimated forecasted expenses and production of the subsequent period. It is most unlikely that the actual expenses incurred and the volume of production will exactly equal the estimates made in respect thereof. Any large discrepancies should be investigated carefully, as they may indicate the necessity for a revision of the rates used.

(3) Certain items may appear in one set of accounts only. Thus, appropriations of profit, such as Income Tax and Sinking Fund instalments for the redemption of Debentures, and *excessive* provisions for depreciation and bad debts, may appear in the financial accounts, but not in the cost accounts, as they do not form part of the normal cost of a firm's products. Conversely, obsolescence of plant and machinery may be taken into account in the costing records, but may not appear in the financial records until the loss has been actually suffered.

In order to reconcile the profits shown by the two sets of accounts, the different classes of expenses are compared and any differences noted. A Reconciliation Statement is then prepared, beginning with the profit shown by the cost accounts and ending with the profit shown by the financial accounts. To facilitate this reconciliation, certain minor modifications of the financial accounts may be effected. For instance, separate accounts may be opened in the financial Nominal Ledger in respect of Direct and Indirect Materials purchased, and Direct and Indirect Wages paid; a special account may be opened for Direct Expenses incurred; the sub-division of expense accounts between Works, Administration, Selling and Distribution may be made to follow

the lines employed in the cost accounts; and so forth. These modifications, although they do not interfere in any way with the preparation of the financial accounts, will assist considerably in reconciling the two net profit figures.

EXAMPLE.

The financial Trading and Profit and Loss Accounts of the Acme Manufacturing Co., Ltd., for the year ended 31st December, 19.., are as follows:—

TRADING AND PROFIT AND LOSS ACCOUNTS

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	£		£
To Materials Consumed	25,550	By Sales	62,225
„ Carriage Inwards	575		
„ Direct Wages	17,255		
„ Works Expenses	6,350		
„ Gross Profit *c/d.*	12,495		
	£62,225		£62,225
	£		£
To Administration Expenses	2,378	By Gross Profit *b/d.*	12,495
„ Selling and Distributive Expenses	3,582		
„ Debenture Interest	500		
„ Net Profit for the year	6,035		
	£12,495		£12,495

The net profit shown by the cost accounts for the year is £6,645. Upon detailed comparison of the two sets of accounts, it is found that:

(i) The amounts charged in the cost accounts in respect of overhead charges are as follows:—

	£
Works Overhead Charges	6,125
Office Do.	2,475
Selling and Distribution Expenses	3,600

(ii) No charge has been made in the cost accounts in respect of Debenture Interest.

The net profits shown by the two sets of accounts may be reconciled as follows:—

		£
Profit as shown by the Cost Accounts		6,645
Add: Office Overhead Charges over-allocated [£2,475 – £2,378]		97
Selling and Distribution Expenses, do. [£3,600 – £3,582]		18
		6,760
	£	
Deduct: Works Overhead Charges under-allocated [£6,350 – £6,125]	225	
Debenture Interest not charged in the Cost Accounts	500	
		725
Profit as shown by the Financial Accounts		£6,035

Standard Costing.

Under this method the cost of an article manufactured under normal or given conditions is taken as the standard cost against which actual costs on subsequent operations can be compared. Thus, the standard cost of the materials used, the wages incurred in transforming the material into the finished product and the overhead charges attachable to the article, are predetermined, and by comparison of the actual cost with the standard cost, the *cause* of any difference may be ascertained, thus enabling the management to take prompt steps to remedy any manufacturing inefficiencies which may thus be revealed.

Standard costing methods are most suitable to industries in which production is continuous and uniform (e.g., paint and varnish works) or where a comparatively limited variety of articles is manufactured on mass production lines (e.g., a motor car manufacturer). They cannot be adopted with any great degree of success where jobs of a distinct and non-recurring nature are undertaken (e.g., a motor repair garage).

The chief advantages secured from the use of standard costs may be summarised as follows :—

(1) Actual performance is easily compared with the predetermined standards, showing separately the profit or loss in the different units of manufacture.

(2) Any variations from standard can be detected in detail. Inefficiencies of labour, use of materials, etc., are thus easily discovered.

(3) Gains and losses due to variations in cost of raw materials, as distinct from variations due to improvement or inefficiency in manufacture, are revealed.

(4) The effect on cost of variations in rates of labour, volume of production, overhead expenses, etc., are shown at short intervals.

This information enables the management to see whether the departments, etc., are working economically, and are maintaining the most remunerative output. It also serves as a guide to whether prices may be reduced to meet competition.

The method of fixing a standard for each element of cost is briefly set out below :—

(1) MATERIALS.—Standard cost is settled having regard for current rates, and those of the immediate future.

Allowance must be made for waste, scrap and any by-products. If a regular discount of, say, 5% is received on purchases of the main product this is sometimes taken into account. A price book showing standard costs should be compiled but care should be taken to see that this is constantly revised and brought up to date.

(2) LABOUR.—All the detailed operations should be settled and a labour rate fixed for each of these. This may be based on piece-work or time rates, whichever are used, and settled by test or experience. Care should be taken to make due allowance for any bonus paid, idle time, special contingencies (e.g., payments made for time lost while sheltering during air raids), etc.

(3) OVERHEADS.—The overhead expenses for each department, or in some cases for each machine, should be budgeted for a period of, say, six months. A standard rate or percentage can then be calculated. This rate may be a percentage of prime cost, wages, or materials, or may be based on machine-hours, or direct labour-hours.

When comparing the actual costs with the standard costs, it will, of course, be necessary to take into consideration any deviation from normal working conditions and any other factors affecting the standard figures, viz. :—

(*a*) Alterations in the cost of material and labour rates ;

(*b*) Breakdown in machinery and stoppages due to any abnormal causes ; and

(*c*) Effects of supernormal and subnormal volumes of production on items of fixed overheads.

Uniform Costing Systems

If all the concerns in a particular branch of industry (e.g., in the boot and shoe industry) could arrive at a standardised system for ascertaining the costs of their products, it would enable the industry to set up a standard against which the results of each individual firm could be measured, and the pooling of costing data and results would enable the industry to base its prices upon accurate costs which would leave a reasonable margin

of profit to each firm, instead of each firm endeavouring to secure trade by indiscriminate cutting of prices. This much granted, however, there remain considerable practical difficulties to be overcome. Mutual confidence is necessary if firms are to pool their data and results for the common good.

Even among firms in the same industry, different methods of production may exist (e.g., one firm may carry out every process on the raw material, whereas a second firm may obtain the material in a partly-processed state from outside suppliers). Moreover, numerous debatable points in costing practice arise which call for uniform treatment if the costing results are to be at all comparable as between one firm and another. Examples of such points are given below :—

(*a*) The bases for the apportionment and allocation of overheads.

(*b*) The exact definition of " Direct " and " Indirect " materials, and the various items which shall be included under each head.

(*c*) What items shall be regarded as factory as distinct from administration expenses.

(*d*) How expenses of administration, distribution and selling are to be dealt with, i.e., the basis of recovery rates.

(*e*) What rates of depreciation shall be applied to plant, machinery and equipment. The division of plant and machinery into classes, for the purpose of fixing depreciation rates for each class.

(*f*) Whether interest on capital is to be included, and, if so, on what basis.

(*g*) What rent charge is to be made for buildings if leasehold, or if owned by the company.

(*h*) The demarcation between productive and non-productive wages.

(*i*) The method of valuing stock of finished goods and work-in-progress.

The question also arises as to what organisation can be set up to prepare the comparative statistics for the use of those adopting the uniform system. Usually some form of central bureau is set up. Privacy of individual data and confidence in the central bureau are essential factors. In order to maintain secrecy the figures in the comparative statements compiled by the central bureau might be shown in percentage form and the names of the companies should *not* be indicated in connection with the figures disclosed.

The British Master Printers' Costing System was the first serious attempt in this country at devising a uniform system of costing which could be applicable to all firms in the same industry, and this system has attained a considerable degree of success.

SINGLE COST ACCOUNTS

Examples are appended of the cost sheets of—

(1) A Colliery. (2) A Biscuit Factory. (3) A Brewery.

Many of these sheets are compiled in columnar form to admit of comparison with other periods, and where they are compiled weekly or monthly, they are usually summarised at the end of the trading period for comparison and reconciliation with the financial accounts as previously indicated.

It should be noted that the figures in the examples of cost sheets and statements on this and subsequent pages are merely illustrative and are not indicative of current costs and prices.

COLLIERY COST SHEET.

Week ended 10th March, 19..

Coal raised, 1,500 saleable tons.

Previous Week, 1,800 saleable tons.

				Cost per ton.			Cost per ton— Previous week.		
	£	s.	d.	£	s.	d.	£	s.	d.
Underground—									
Colliers' Wages	1,000	0	0	0	13	4	0	13	2·5
Checking	130	0	0	0	1	8·8	0	1	8·5
Roads	40	0	0	0	0	6·4	0	0	6·3
Sundry Wages	30	0	0	0	0	4·8	0	0	4·7
Pitwood	140	0	0	0	1	10·4	0	1	10
Stores	154	0	0	0	2	0·6	0	2	0
Haulage	95	0	0	0	1	3·2	0	1	3·5
Surface Costs—									
Pickers and Labourers	500	0	0	0	6	8	0	6	8
Blacksmiths	40	0	0	0	0	6·4	0	0	6·2
Pumpmen	75	0	0	0	1	0	0	1	0
Winding	35	0	0	0	0	5·6	0	0	5·6
Weighing	30	0	0	0	0	4·8	0	0	4·8
Other Wages	20	0	0	0	0	3·2	0	0	3·4
Stores	120	0	0	0	1	7·2	0	1	6·4
Horsekeep	55	0	0	0	0	8·8	0	0	8·7
Distribution Costs—									
Truck Hire	110	0	0	0	1	5·6	0	1	4·5
Carriage	420	0	0	0	5	7·2	0	5	7
Establishment and other charges—									
Royalties	30	0	0	0	0	4·8	0	0	4·8
Rates and Insurances	23	0	0	0	0	3·7	0	0	3·7
General Expenses	15	0	0	0	0	2·4	0	0	2·3
Commission and Discount	45	0	0	0	0	7·2	0	0	7·2
Depreciation	30	0	0	0	0	4·8	0	0	4·4
	£3,137	0	0	£2	1	9·9	£2	1	4·5

BISCUIT RETURN—CRACKER DEPARTMENT.

Date—24th May, 19..

No. 15 Cracker.

Ovens—No. 5	49½	hours.
,, ,, 7	49½	,,
,, ,, 9	49½	,,
	148½	,,

	lbs.	@		£ s. d.	Cost per cwt. £ s. d.
Materials—					
Flour	8,400	35/- sack		52 10 0	
Shortening	140	72/- cwt.		4 10 0	
Sugar	35	54/- cwt.		0 16 10½	
Other ingredients	14	..		0 5 0	
	8,589 lbs.			58 1 10½	
Less value of waste	700 ,,	4/- cwt.		1 5 0	
				56 16 10½	0 16 2½
MADE—2,500 tins=70 cwt.					
Wages—					
Oven Hands			10 0 0		
Packing			7 0 0		
Labelling			1 10 0		
				18 10 0	0 5 3½
Machine Oven Expenses—					
Heating			22 5 0		
Greasing Plates			4 10 0		
Power and Lubrication			3 5 0		
Repairs			1 2 6		
Depreciation			6 0 0		
				37 2 6	0 10 7½
General Works Expenses—					
(Department Allocation)—					
Re-tinning Department			3 2 6		
Repairs to Plant			2 7 0		
Rent, Rates, Insurance, etc.			4 2 0		
Depreciation—Engine, etc.			1 17 6		
Salaries and Indirect Wages at Works			10 12 6		
				22 1 6	0 6 4
Selling and Administration Expenses—					
(Proportion)—					
Travellers' Salaries and Commission			12 2 6		
Carriage			15 10 0		
Renewal of Cases and Tins			7 15 0		
Advertising			10 0 0		
Salaries and Office Expenses			5 14 0	51 1 6	0 14 7
				£185 12 4½	£2 13 0½

Quantity—Cost per cwt. . . . £2 13 0½

The next illustration is given in the form of a fully worked answer, which should be carefully studied.

EXAMPLE.

From the following particulars of the "Audit Ale" Brewery, Ltd., at 31st December, 19.., viz.:—Wages, £5,550; coal and oil, £5,087 10s.; cooperage, corks, and shives, £1,850; malt, £20,350; hops, £5,550; beer duty, £132,275; water, £462 10s.; rent, £2,775; by-products, £1,850; sugar finings, etc., £7,400; repairs, £1,387 10s.; depreciation, £462 10s.; selling and distribution expenses, £14,250; stock of beer (1st January), £9,800 (2,000 barrels); stock of beer (31st December), £4,900 (1,000 barrels); beer sales, £243,200 (38,000 barrels); beer brewed, 37,000 barrels, prepare accounts showing—

(*a*) Prime cost per barrel.
(*b*) Total cost per barrel.
(*c*) Profit per barrel.

PRODUCTION STATEMENT.

YEAR ENDING 31ST DEC., 19..

Total Beer Brewed=37,000 Barrels.	Total Cost. £	s.	d.	Cost Per Barrel. £	s.	d.
MATERIALS USED—						
Malt	20,350	0	0	0	11	0
Hops	5,550	0	0	0	3	0
Sugar Finings, etc.	7,400	0	0	0	4	0
Beer Duty	132,275	0	0	3	11	6
Water	462	10	0	0	0	3
	166,037	10	0	4	9	9
Less proceeds from sale of by-products	1,850	0	0	0	1	0
Cost of Materials used	164,187	10	0	4	8	9
WAGES	5,550	0	0	0	3	0
Prime Cost of Production	169,737	10	0	4	11	9
BREWERY EXPENSES—						
Coal and Oil	5,087	10	0	0	2	9
Cooperage, corks, and shives	1,850	0	0	0	1	0
Rent	2,775	0	0	0	1	6
Repairs	1,387	10	0	0	0	9
Depreciation	462	10	0	0	0	3
Total Cost of Production	£181,300	0	0	£4	18	0

BREWING ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DEC., 19.. *Cr.*

	Total. £	s.	d.	Per Barrel. £	s.	d.		Total. £	s.	d.	Per Barrel. £	s.	d.
To Materials used	164,187	10	0	4	8	9	By Balance transferred to Trading Account	181,300	0	0	4	18	0
„ Wages	5,550	0	0	0	3	0							
„ Brewery Expenses	11,562	10	0	0	6	3							
	£181,300	0	0	£4	18	0		£181,300	0	0	£4	18	0

TRADING ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DEC., 19.. Cr.

	Barrels.	Total. £ s. d.	Per Barrel. £ s. d.		Barrels.	Total. £ s. d.	Per Barrel. £ s. d.
To Stock at 1st Jan.	2,000	9,800 0 0		By Sales . .	38,000	243,200 0 0	6 8 0
„ Cost of Production . .	37,000	181,300 0 0	4 18 0	„ Stock, 31st Dec.	1,000	4,900 0 0	
„ Selling and Distribution Expenses . .		14,250 0 0	0 7 6				
„ Balance, Profit .		42,750 0 0	1 2 6				
	39,000	£248,100 0 0	£6 8 0		39,000	£248,100 0 0	£6 8 0

NOTE.—It will be observed that the figures in the "Per Barrel" column in respect of Selling and Distribution Expenses and Profit are computed by reference to the number of barrels *sold*.

JOB COST ACCOUNTS

To show the main features of this class of account, examples are subjoined of—

(1) Printer's cost sheet.

(2) General outline of boot manufacturer's system (departmental costs).

(3) General outline of clothing manufacturer's system.

PRINTER'S AND PUBLISHER'S COST SHEET.

ORDER No. 917. DATE, 5th *June*, 19..

Description—1000 copies, "Something for Nothing."

Particulars.		Departmental Details. £	s.	d.	Departmental Totals. £	s.	d.	Totals. £	s.	d.
PRINTING DEPARTMENT.										
Materials :	Paper	210	0	0						
	Ink	31	10	0	241	10	0			
Labour :	Compositors . .	164	0	0						
	Proof Readers .	31	10	0						
	Printers . .	63	0	0	258	10	0			
Works Overheads at 40 per cent. on £500 .					200	0	0	700	0	0
BINDING DEPARTMENT.										
Materials :	Boards	62	7	6						
	Leather . . .	56	3	0						
	Cloth	79	4	6						
	Endleaves . .	–	–	–						
	Gold	–	–	–						
	Sundries . . .	19	8	6	217	3	6			
Labour :	Folding . . .	6	4	0						
	Sewing	4	1	2						
	Cutting	4	9	6						
	Binding . . .	15	1	4						
	Finishing . . .	6	3	0	35	19	0			
Works Overheads at 35 per cent. on £253 2s. 6d.					88	11	10	341	14	4
Office Overheads at 12½ per cent. on £1,041 14s. 4d. . .								130	4	3
								£1,171	18	7

Cost per copy . . . . £1 3s. 5d.

Boot Manufacturer's Costing.

In boot manufacturing there are several departmental processes for which separate costs must be ascertained before the final cost sheet can be prepared. For example, the skins from which the uppers are cut vary in size and quality, and the cutter or "clicker" obtains a variable quantity of the different parts, legs, goloshes, etc., from each skin. Similarly, with the sole leather, the bends or butts produce a variable quantity of soles, heels, and "rough stuff," the latter being used for building up the heels or other parts.

For these operations, a "Production" statement is prepared in the following or similar manner :—

Dr. PRODUCTION STATEMENT (Skins). *Cr.*

	£ s. d.		£ s. d.
To Materials—		By Production—	
... Skins (Box-calf, Glacé, etc.) @ . .		... Goloshes @ . .	
" Wages . . .		... Legs @ . .	
		... Toecaps @ . .	
		... Back Straps, etc., @	
	£		£

The account is credited with the proportionate value of the finished article, and the balance will be either a "profit" or "loss" on production. Usually there is a slight profit, but so much depends upon the quality of the skin.

A similar statement is prepared for the Sole Leather, the statement being debited with the value of the butts, bends, etc., and wages paid, whilst it is credited with the proportionate value of the articles produced.

For the "Closing" room, where the various parts for the "uppers" are assembled and sewn, the production statement is debited with the value of the different parts and wages paid, whilst it is credited with the value of the completed "uppers."

Production statements are also compiled for other processes, including those of the making and operating room, where the sole, etc., is attached to the upper and the boot is actually made; and of the "finishing" room, where various small processes are undergone before the boot is in a fit condition for sale. Each of these departments compiles a production statement, daily or weekly, showing the operating cost in each case. Finally,

these statements are amalgamated and reconciled with the financial accounts.

In the boot and shoe industry, production is initiated by means of a production order from the works manager or Planning Department to produce a "batch" of (say) 100 pairs of a certain type of boot or shoe. This "batch" is allotted a Job (or Production) Order Number, and is treated as a "job" for costing purposes, a separate cost summary being compiled for each "order," as shown in the following example :—

COST SUMMARY.

PRODUCTION ORDER NO :—*103.*

DATE, 17*th February,* 19..

QUANTITY AND DESCRIPTION. } 1,000 pairs Men's Box-calf Shoes, Pattern No. 6473B

	£	s.	d.	£	s.	d.
MATERIALS—						
Uppers	115	10	0			
Trimmings	67	7	6			
Bottom Stuff	16	3	8			
Grindery	31	15	0			
				230	16	2
WAGES (where not included in price of Materials, e.g., Uppers, etc.)	179	6	4	179	6	4
Factory Overheads at 40% on £410 2s. 6d.				164	1	0
Office Overheads at 10% on £574 3s. 6d.				57	8	4
				£631	11	10

	£	s.	d.
Average Cost per pair	0	12	7·6
Selling price	0	15	6

Clothing Manufacturer's System.

The following is a general outline of a clothing manufacturer's costing system. Each job is separately booked to the "cutter-out," who is supplied with the necessary cloth, accompanied by an instruction sheet (Form 1). The unmade garment is parcelled, and, accompanied by the duplicate instruction sheet, is passed through the "trimmings" warehouse, where buckles, buttons, etc., are added; then it reaches the workroom, where the garment is made. At each stage, the cost of the various processes is marked on the original instruction sheet, which is finally passed to the costing department.

The cost sheet is made out on Form No. 2, the establishment charges being charged on a percentage basis previously determined. The separate cost sheets are entered in a Cost

Summary Book (Form No. 3), and totalled monthly. At the end of the year, the monthly totals are summarised and, after adjusting work-in-progress, etc., the grand total is reconciled with the financial books.

Form No. 1.

INSTRUCTION SHEET. *15th Feb.* 19..

CUTTING No. 2871 STOCK No. L. 93 QTY. 10 SIZES 1/4, 3/5, 3/6, 3/7 Stock	DESCRIPTION. Lounge Suits Patt. x. 19.

MATERIALS.						LABOUR.		
Ref. No.		Price.		Yards.	Stock-keeper's Initials.		Price. paid.	
		s.	d.				s.	d.
P. 19	Vicuna . .	17	6	40	J. H.	Cutting . .	35	0
F. 4	Italian . .	1	6	15	J. H.	Machining .	19	6
S. 35	Canvas . .		9	8	M. P.	Buttonholing .	2	6
B. 5	Pocketing . .	1	0	3	J. H.	Finishing . .	3	3
B. 9	Sleeve Lining .	2	0	10	M. P.	Pressing . .	5	0

Ref. No.	Qty.	Trimmings.	Price.		Dept.	Date.	
						Recd.	Left.
			s.	d.		19..	19..
B. 15	*	Buttons			Cutting Room .	16th Feb.	17th Feb.
		Buckles .	12	0	Fitting Room .	17th Feb.	19th Feb.
		etc., etc.			Workroom .	19th Feb.	23rd Feb.
					Stockroom .	23rd Feb.	

* In practice a separate standard cost card for buttons, etc., is made up for regular lines, and the button cost per suit or garment is included in the above cost sheet. For special cutting orders, full details must be given.

Form No. 2.

COST SHEET.

C. No. 2871
S. No. L. 93

QUANTITY AND DESCRIPTION. *24th February,* 19...
10 Lounge Suits. Patt. x19.

Yardage or Quantity. per unit.	Total Yardage or Quantity.		Price.		
			s. d.	£ s. d.	£ s. d.
		MATERIALS			
	40	Vicuna . . .	17 6	35 0 0	
	15	Italian . . .	1 6	1 2 6	
	8	Canvas . . .	0 9	0 6 0	
	3	Pocketing . . .	1 0	0 3 0	
	10	Sleeve lining . .	2 0	1 0 0	
		Buttons, Buckles, etc. .	12 0	0 12 0	
					38 3 6
		LABOUR			
		Cutting . . .		1 15 0	
		Machining . . .		0 19 6	
		Buttonholing . .		0 2 6	
		Finishing . . .		0 3 3	
		Pressing . . .		0 5 0	3 5 3
		PRIME COST .			41 8 9
		ESTABLISHMENT CHARGES	25%		10 7 2
		TOTAL COST .			£51 15 11
		Average Cost for one suit			£5 3 7

Form No. 3.

COST BOOK SUMMARY.

C. No.	Description.	Materials.	Labour.	Establishment Charges.	Total.
		£ s. d.	£ s. d.	£ s. d.	£ s. d.
2871	10 Lounge Suits, Patt. x.19 . . . etc.	38 3 6	3 5 3	10 7 2	51 15 11

PROCESS COST ACCOUNTS

In process accounts each separate process may be considered as a separate department, being debited with materials, wages and its due proportion of establishment expenses, and credited with its output at cost, or in some cases at a fixed departmental selling price. The cost price or selling price is charged to the next process and the same procedure repeated, the completed product of the first process being the raw material of the second and so on. If cost price is used the process accounts will show neither profit nor loss, but where goods are transferred from one department to another at a fixed price, each department will show the profit or loss on its working. The following is an example of the former class of account.

PROCESS COST ACCOUNT

For Works employing Chemical Processes and Food Industries.

TROPICAL REFINERY

Week ending 7th January, 19..

Preparation Account.

	TONS.	£		TONS.	£
To Copra . . .	650	16,940	By Crude Oil to Refining Account (No. 1) . .	350	17,185
" Wages . . .		100	" Sales of Residuals .	300	150
" Steam for Heating .		55			
" Rent, Rates and Expenses . .		240			
	650	£17,335		650	£17,335

Refining Account (No. 1).

	TONS.	£		TONS.	£
To Preparation Account	350	17,185	By Blending Account .	130	10,730
" Sundry Materials .		340	" Refining Account (No. 2) . .	150	6,940
" Wages . . .		200	" Sundry Sales Account . .	50	500
" Steam for Heating .		140	" Loss in Process .	20	
" Rent, Rates and Expenses . .		305			
	350	£18,170		350	£18,170

Refining Account (No. 2).

	TONS.	£		TONS.	£
To Refining Account (No. 1) . .	150	6,940	By Blending Account .	80	7,550
" Sundry Materials .		320	" Sales Account .	60	240
" Wages . .		180	" Loss in Process .	10	
" Steam for Heating .		120			
" Rent, Rates and Expenses . .		230			
	150	£7,790		150	£7,790

Blending Account.

	TONS.	£		TONS.	£
To Refining Account (No. 1) . . .	130	10,730	By Sales Account .	195	18,525
„ Refining Account (No. 2) . . .	80	7,550	„ Loss in Process .	15	
„ Wages		70			
„ Power		25			
„ Rent, Rates and Expenses . .		150			
	210	£18,525		210	£18,525

Cost of Copra, £26 1s. $2\frac{3}{4}$d. per ton.
Cost of Refined Oil No. 1, £82 10s. $9\frac{1}{4}$d. per ton.
Cost of Refined Oil No. 2, £94 7s. 6d. per ton.
Cost of Crude Oil, £49 2s. 0d. per ton.
Cost of Finished Product, £95 per ton.

If the product is transferred from one process to another at a fixed departmental price, the unrealised inter-process profits must be eliminated when the stocks are valued for Balance Sheet purposes.

EXAMPLE.

On 31st December, 19. ., it is ascertained that the stock in process B is £2,000 and that the cost of the work done in process B is exactly equal to the price at which the goods are received from process A. The goods are transferred from process A to process B at cost plus 25 per cent.

The inter-process profit included in the stock is ascertained as follows :—

One-half of the work done on the £2,000 stock was done in process B and without the addition of profit. £1,000, however, was the value at which the goods were transferred from process A to process B, and this includes a profit of 25 per cent. *on cost.* A reserve must therefore be made of 20 per cent. on the *transfer price* of £1,000, i.e., £200 and the stock of process B will be valued at £2,000 less £200, i.e., £1,800 for Balance Sheet purposes. If the goods had passed through another process, any profit added by *both* processes would have to be reserved for, in respect of that portion of the stock which came through both processes.

OPERATING COSTS.

The following is an example of an operating cost sheet used by a motor haulage firm for finding the cost per ton-mile of running their motors.

The various expenses are set out in detail along with the record of work done, and the weekly average shows a continuous comparison.

HISTORY OF RUNNING COSTS.

No. 5.
LORRY TYPE. *Vulcan*, 5 ton.
PURCHASED: *20th July*, 19..

DETAILS: *Model C.*
COST: £1,500.

Week.	Mileage.	Ton Mileage.	Wages.	Petrol and Oil.	Tyres.	Taxes and Insurance.	Repairs.	Depreciation.	Running Cost per ton-mile.
			£	£	£	£	£	£	d.
July 29th .	300	500	3·5	4·7	2·3	1·2	..	4·3	7·7
August 6th	..	..	..	..	..	..	..	..	..
„ 13th	..	..	..	..	..	..	..	..	..

The above Motor Record is for showing the work done by each machine and the charges incurred. It is written up from the summary of drivers' individual statements shown below. The running cost per mile in the statement below is found by dividing the total cost (col. 13) by the ton-miles (col. 5). The ton-miles will be found by multiplying the load carried by the distance of the journey and totalling these products for each motor. This method can be used in any business where a motor is maintained, and the cost of delivery, etc., can be checked against outside charges.

THE EDGELEY HAULAGE CO.

SUMMARY OF DRIVERS' STATEMENTS FOR THE WEEK ENDING NOVEMBER 29TH, 19

No.	Name	Machine.	Total. Miles.	Total Loads in Ton-Miles.	Cost.							Total Cost.	Cost per ton-mile.	Earnings.	Balance	
					Wages.	Petrol.	Oil.	Tyres.	Repairs.	Taxes and Ins.	Depreciation.				Profit.	Loss
					£	£	£	£	£	£	£	£	d.	£	£	£
1	*Smith* ..	*Vulcan*	300	500	3·5	4·5	·2	2·3	..	1·2	4 3	16·0	7·7	28·0	12·0	..
2	*Hughes*	*A.E.C.*	400	800	3·5	6·3	·4	3·5	10	1·1	4·7	29·5	8·85	39·5	10·0	..
3	*Williams*	*Ford*	600	500	2·5	5·0	·3	2·5	..	·6	1·4	12·3	5·9	20·0	7·7	..
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)

EXERCISE 16.

A. What are the various classes of Cost Accounts, and to what manufactures or industries are they applicable?

B. What books (other than the usual financial books) are necessary in connection with the keeping of Cost Accounts? Explain their use.

C. Define the following, and indicate in which industries or undertakings the different classes could be suitably applied :—

(1) Single Costs.
(2) Terminal Costs.
(3) Operating Costs.
(4) Multiple Costs.
(5) Process Costs.
(6) Departmental Costs.

D. Briefly explain the advantages of keeping Cost Accounts.

E. (*a*) For the purpose of costing, under what three divisions is expenditure classified ?

(*b*) Mention what exactly is included in the classified divisions which you have named under (*a*).

F. Outline a method of store-keeping which will enable the value of the stores in hand to be ascertained at any time with the minimum of labour.

G. Discuss the various bases on which establishment charges may be distributed, and argue which of these bases you would recommend in the case of a cotton spinning factory or other industry with which you are acquainted.

H. Give an explanation with rulings and specimen entries of a system of Costing with which you may be familiar.

I. A manufacturer finds that the cost account does not agree with the estimate for the same work. Can you explain this ?

J. A company desires to inaugurate an efficient system of cost accounts in connection with the manufacture of several distinct kinds of goods. You are required to select a business and to explain how the costing system should be constructed, mentioning three items which you would include amongst the establishment charges, and stating how you would apportion such charges between the different departments.

K. Tabulate the " Elements of Cost," showing the usual items of expenditure appertaining to each.

L. Describe the various methods of allocating "Overheads" (or "Oncost"). Explain their respective advantages and disadvantages.

M. How can one ascertain that the expenses charged to the cost accounts in the cost ledger, total up to an amount corresponding to the expenses shown in the nominal accounts ? What has to be done with the difference in these, if they do not agree ?

N. Taking an ordinary financial trading account, marshal the items into groups representing :—

(*a*) Manufacturing expenses.
(*b*) Administration expenses.
(*c*) Selling expenses.

O. What are the essentials of a good costing system ? Give a typical expense distribution schedule, showing names of accounts, applicable to any industry with which you are acquainted.

P. From the following figures ascertain the

(*a*) Cost of materials used.
(*b*) Value of output of manufactured goods.
(*c*) Cost of sales.
(*d*) Percentage of gross profit on sales.

Dr. TRADING ACCOUNT, for the year ended........19.. *Cr.*

	£	£		£	£
To Stocks :—			By Sales		84,000
Finished Goods	8,000		,, Stocks :—		
Raw Materials .	2,400		Finished Goods .	7,000	
		10,400	Raw Materials .	2,800	
,, Purchases . . .		24,000			9,800
,, Wages . . .		40,000			
,, Carriage . . .		2,000			
,, Gross Profit . .		17,400			
		£93,800			£93,800

Q. Draft a form of cost sheet for a colliery, showing analysis of underground and surface wages, working expenses (in detail) and administration and establishment charges.

R. Draw up a system of cost accounts for a building contractor, and show how they would be co-ordinated with the financial accounts of the business.

S. A manufacturer of matches desires you to devise a system of cost accounts for his factory, and thereafter to audit them.

Assume that the power employed is electricity, and briefly describe the various items which it would be necessary to deal with.

Classify these elements of cost in the groups into which you would divide them, and state the sources from which you would derive the necessary details.

T. From the following information prepare Pig Iron Production Account, showing the cost per ton of each class of expenditure and of the pig iron produced :—

Sundry Stocks on hand, 1st January, 1940—Coal, £4,720 ; Coke, £3,580 ; Limestone, £1,450 ; Ironstone, £3,930 ; Sundries, £2,700.

Purchased during the year—Coal, £21,880; Coke, £29,470; Limestone, £5,080; Ironstone, £18,690; Sundries, £7,810.

Sales of Slag, £10,400; General Works Charges, £4,400; Wages, £17,600; Production of pig iron, 32,000 tons.

Stocks on hand, 31st December, 1940—Coal, £3,800; Coke, £2,650; Limestone, £1,730; Ironstone, £3,420; Sundries, £2,910.

U. The accounts of the Century Engineering Co., Ltd., show for 19..—

	£
Material used	175,000
Manual and Machine Labour Wages directly chargeable .	135,000
Works Overhead Expenditure	37,125
Establishment and General Expenses	23,250

Show the Works Cost and Total Cost, the percentage that the Works Overhead Cost bears to the Manual and Machine Labour Wages and the percentage that the Establishment and General Expenses bear to the Works Cost.

What price should the Company quote to manufacture a machine which, it is estimated, will require an expenditure of £750 in material and £600 in wages so that it will yield a profit of 25% on the total cost or 20% on the selling price? Answer to the nearest £.

V. A pencil manufacturer makes two types of pencils, "Black" and "Coloured." They undergo two processes, Factory and Finishing. Raw Materials used in the Factory and General Expenses are apportioned in the ratio of output of each class; the output in 19.. was 24,000 gross Black and 8,400 gross Coloured; the actual cost of labour for each process is ascertained; "other charges" for each process are apportioned in the same ratio as labour for that process; finishing materials are apportioned in the ratio of finishing labour. From the following particulars prepare a statement of the cost per gross, in shillings and pence, of each item and each process in the cost of manufacture; and the profit per gross if the selling prices are £1 and 19s. respectively.

	£
Factory Raw Materials, Opening Stock	3,680
,, ,, Purchases	10,710
,, ,, Closing Stock	4,940
Factory Wages, Black	4,200
,, Coloured	1,365
Factory Charges	3,710
Finishing Wages, Black	2,000
,, Coloured	560
Finishing Raw Materials, Opening Stock	720
,, ,, Purchases	3,370
,, ,, Closing Stock	890
Finishing Charges	1,920
General Expenses	3,645

W. A business has three distinct manufacturing departments using materials in the proportions of A, 5½; B, 3; and C, 1½. From the following information you are required to find the total cost of production for each department for the year 19.., and to ascertain the cost per hour of each machine working on a basis of a 40-hour week throughout the year.

	£
Stock on 1st Jan., 19.. (Raw materials)	3,000
,, ,, (Finished goods)	4,370
Stock on 31st Dec., 19.. (Raw materials)	3,500
,, ,, (Finished goods)	5,460
Purchases for the year to 31st Dec., 19..	12,000
Productive Wages ,, ...	9,000
Non-productive Wages ,, ...	972
Sales ,, ...	32,500
Rents, Rates, etc. ,, ...	783
Repairs ,, ...	342
Lighting, Heating, and Power for the year to 31st Dec., 19..	738
Depreciation on Plant ,, ,,	836
Salaries ,, ,,	1,503
General Expenses ,, ,,	1,350
Discounts allowed ,, ,,	765

The wages of each Department are :—

(*a*) £5,000 in connection with 6 machines
(*b*) £3,000 in connection with 4 machines
and (*c*) £1,000 in connection with 1 machine.

In the absence of any further information, all expenses, with the exception of depreciation, are to be charged to the departments in the same proportion as the wages paid, depreciation being apportioned in the same ratio as the number of machines in departments.

X. From the following Cost Ledger Accounts Balances, construct a Manufacturing Account :—

	£		£
Stores	683	Finished Stock . .	8,754
Direct Materials . .	12,673	Direct Wages . . .	24,341
Works Overheads . .	23,274	Sales from Stock . .	1,003
Direct Expenses . .	228	Profit on Completed Jobs .	11,069
Job No. 397 . . .	571	Office Overheads Suspense Account . . .	208
Job No. 426 . . .	982	Completed Jobs Account .	65,789
Profit on Sales from Stock	230	Works Overheads Suspense Account . . .	515
Office Overheads . .	5,324		

Y. A firm of builders, carrying out large contracts, kept, in a Contract Ledger, separate accounts for each contract. On the 30th June, 1941, the following was shown as being the expenditure in connection with Contract No. 777 :—

	£
Materials Purchased	58,063
Materials from Stores	9,785
Plant which has been used on other Contracts . .	12,520
Additional Plant Purchased	3,610
Wages	74,634
Direct Expenses	2,026
Proportion of Establishment Charges	8,720

The Contract, which had been commenced on 1st February, 1941, was for £300,000, and the amount certified by the architect, after deduction of 20% retention money, was £120,800, the work being certified on 30th June, 1941. The materials on the site at that date were valued at £9,858. A Contract Plant

Ledger was also kept, in which depreciation was dealt with monthly ; the amount debited in respect of plant on Contract No. 777 to 30th June, 1941, was £1,130.

You are required to prepare an account showing the profit on the Contract to 30th June, 1941.

Z. (*a*) What is meant by Uniform Costing? What advantages would you expect to accrue from the institution of a uniform system of costing throughout an industry ?

(*b*) What do you understand by Standard Costs ? To what industries or classes of products do you consider them applicable ? How are they compiled and how are they used to reflect efficiency in manufacture ?

CHAPTER XVII

DOUBLE ACCOUNT SYSTEM ; ACCOUNTS OF BANKS

THE DOUBLE ACCOUNT SYSTEM

THE customary method of compiling a commercial Balance Sheet is to marshal the whole of the assets on one side of the statement, and to arrange the whole of the liabilities and capital on the other side of the statement. The fact that the Balance Sheet is thus drafted as one statement results in this method being termed the "Single Account" System, to distinguish it from the "Double Account" System under which the Balance Sheet is drawn up in two divisions, viz. :—

(1) RECEIPTS AND EXPENDITURE ON CAPITAL ACCOUNT, which shows on the *credit* side the amount raised for the purposes of the business (e.g., shares, stock, debentures and debenture stock, together with premiums thereon, less discounts) ; and on the *debit* side how the amount has been expended on the fixed assets (e.g., land and buildings, fixed plant, rolling stock, etc.) ; and the balance of capital in hand or over expended.

(2) GENERAL BALANCE SHEET, which sets out the floating assets and liabilities, including the stock, debtors, cash, creditors, the depreciation account, and the balances of the revenue account and of the capital account.

The object of the Double Account System is to show what capital has been raised, and for what purpose it has been expended in the undertaking, rather than to show the present value of the assets at any given date, as is done in accounts prepared on the single account system. The books are prepared by double entry, as in the case of the single account system, but there is an important difference in respect of the treatment of depreciation, all charges for repairs, renewals and replacements in the double account system being charged to revenue, and no special provision being made in the statutory form of account for the assets to be shown at less than original cost. Frequently, however, in practice a Depreciation and Renewals Reserve Fund is raised by means of transfers each year from net revenue, the object being to avoid violent fluctuations in the charge for renewals as between

successive years, and to equalise, as far as possible, the yearly charge against profits. The Depreciation Fund (if any) appears on the liabilities side of the General Balance Sheet, while the asset remains at its original cost on the debit side of the Capital Account.

The use of the Double Account System was first prescribed under the Regulation of Railways Act, 1868, and is generally adopted by companies or undertakings whose capital is specifically raised for the acquisition or construction of works of a permanent nature, such as railways, tramways, electricity supply companies, gasworks, and waterworks. The departmental accounts of local or municipal authorities which have acquired or constructed undertakings of the nature here described are invariably compiled on this system, and in the case of the following companies, whose undertakings are of a public or semi-public nature, the adoption of the system and of special forms of accounts is compulsory :—

(1) Railway and Tramway Companies governed by the Regulation of Railways Act, 1868, and the Railway Companies (Accounts and Returns) Act, 1911, as amended by the Railway Companies (Accounts and Returns) Order, 1928.

(2) Parliamentary Gas Companies governed by the Gas Works Clauses Act, 1871, as amended by the Gas Regulation Act, 1920.

(3) Electric Lighting Companies governed by the Electric Lighting Acts, 1882 to 1909, as amended by the Electricity (Supply) Act, 1919.

Water companies, incorporated by special Act of Parliament and governed by the Waterworks Clauses Acts, 1847, usually adopt this system, but in their case no special statutory form of accounts is prescribed.

The detailed forms of these accounts are very complex, especially with regard to railways, in the case of which separate "receipts and expenditure" accounts are required for each phase of railway working, e.g., for the railway proper, steamboats, canals, hotels, etc., and sub-statements are required to show the details for each of the various sections. These detailed accounts are, however, beyond the scope of this work, and the reader is referred to the above-mentioned Acts for further information.

The terms "Trading Account" and "Profit and Loss Account" are not used in connection with these companies, the accounts being described as "Revenue" and "Net Revenue" Accounts respectively. The composition of these accounts varies with the different companies, but, as a general rule, the Revenue Account includes all items relating to the productive working of the undertaking, and its balance is transferred to

the Net Revenue Account, in which are usually charged such items as Debenture Interest, Dividends, Transfers to Reserve, etc.

Receipts and Expenditure on Capital Account.

This account, more briefly termed the Capital Account, is generally in columnar form, showing, on the credit side, the capital receipts to the date of the previous balance sheet, receipts during the year, and total receipts to date. Expenditure is shown in a similar manner on the debit side. It is interesting to note that receipts from issues of Debentures or Debenture Stock are included in this account, in contradistinction to the general commercial practice in the case of the Single Account System, where debentures are treated as loans and amounts so raised are kept quite distinct from Share Capital.

An example of an account drawn up on this system and the General Balance Sheet is given below. The abbreviations "Dr." and "Cr." are commonly used in these statements, although they are usually omitted on the balance sheets of commercial companies.

THE NORTHERN RAILWAY COMPANY

Dr. RECEIPTS AND EXPENDITURE ON CAPITAL ACCOUNT. Cr.

	Amount expended to 31 Dec., 19...	Expended during year.	TOTAL.		Amount received to 31 Dec., 19...	Received during year.	TOTAL.
	£	£	£		£	£	£
To Expenditure on—				By Preference Stock	8,500,000		8,500,000
Lines open for Traffic	9,600,000	3,000,000	12,600,000	„ Ordinary Stock	8,000,000	2,000,000	10,000,000
Working Stock	3,200,000	300,000	3,500,000	„ Balance of Premiums and Discounts on Stock	550,000	220,000	770,000
Steamboats	1,600,000	200,000	1,800,000	„ Debentures	3,300,000		3,300,000
Docks, Harbours and Wharves	1,500,000		1,500,000		£20,350,000	£2,220,000	£22,570,000
Hotels	900,000		900,000				
„ Subscriptions to other Companies	1,000,000		1,000,000				
	£17,800,000	£3,500,000	21,300,000				
Balance carried to General Balance Sheet			1,270,000				
			£22,570,000				£22,570,000

GENERAL BALANCE SHEET.

Dr. As at 31st December, 19.. Cr.

Liabilities.	£	19..*	*Assets.*	£	19..*
To Capital Account, Balance at credit	1,270,000		By Cash at Bank	137,000	
„ Net Revenue Account, Balance at credit	32,000		„ Cash on Deposit	450,000	
„ Renewals Reserve Account	250,000		„ Investments	290,000	
„ Sundry Creditors	125,000		„ Stores	250,000	
			„ Sundry Debtors	550,000	
	£1,677,000			£1,677,000	

* These columns are for the figures of the previous year.

The difference between the presentation of the accounts of companies operating under the Double Account System and those drawn up under the usual Single Account System is shown in the following illustration.

(1) *Double Account System*—

Dr. CAPITAL ACCOUNT. *Cr.*

	£		£
To Fixed Assets (in detail)	61,500	By Ordinary Stock	50,000
„ Balance	13,500	„ Debentures	25,000
	£75,000		£75,000

Dr. GENERAL BALANCE SHEET. *Cr.*

Liabilities.	£	*Assets.*	£
Balance of Capital Account	13,500	Stocks and Stores	12,750
Revenue Account	4,500	Cash at Bank	8,250
Depreciation Fund	3,000		
	£21,000		£21,000

(2) *Single Account System*—

BALANCE SHEET.

Liabilities.	£	*Assets.*	£	£
Share Capital—		Fixed Assets (in detail)	61,500	
Ordinary Shares	50,000	*Less* Depreciation	3,000	
Debentures	25,000			58,500
Profit and Loss Account	4,500	Stocks and Stores		12,750
		Cash at Bank		8,250
	£79,500			£79,500

Revenue Accounts.

The Revenue Account shows in debit and credit form the gross trading receipts (credit side) and expenditure (debit side) of the undertaking, followed by the income received from investments and miscellaneous sources, the final balance representing the total net income for the period. In the case of railways, the gross receipts and expenditure of each department are shown in separate schedules, the totals being summarised in the Revenue Account, which is merely a statement not in debit and credit form. The balance of the Revenue Account is carried to the Net Revenue Account in the same way that the balance of the Profit and Loss Account is carried to the Appropriation Account.

The Net Revenue Account commences with the balance brought forward from the previous year; to this is added the balance transferred from the Revenue Account; deductions are then made for debenture interest, preference and guaranteed stock

interest and other fixed charges, the net balance remaining representing the amount available for dividend on the ordinary stock. There is, therefore, a certain distinction between a Net Revenue Account and an Appropriation Account, as such fixed charges as debenture interest, in the case of an ordinary trading company, would be debited before the balance of profits is carried down to the Appropriation Account. In the case of railway companies this account is not in debit and credit form, whereas in the case of other companies (e.g., gas and electric lighting companies) it takes the usual form of a Profit and Loss Appropriation Account. Railway Companies present their Net Revenue Accounts in tabular form, showing the corresponding figures of the previous period, and it is also necessary to insert at the foot of the "statement" the proposed appropriation of the balance available.

An example of revenue accounts of a railway company drawn up under this system is given below. The detailed accounts leading up to the revenue account are not given for as mentioned previously these accounts are beyond the scope of this work.

REVENUE RECEIPTS AND EXPENDITURE ACCOUNT.
FOR YEAR ENDED 31ST DECEMBER, 19..

See Account No.			Net Receipts.	Year 19..*
			£	£
	Railway		62,000	
	Steamboats		37,000	
	Docks, Harbours and Wharves		35,000	
	Hotels, Refreshment Rooms and Cars where catering is carried on by the Company		40,500	
	Collection and Delivery of Parcels and Goods		64,000	
			238,500	
Add—				
	Jointly owned and jointly leased lines— Company's proportion of net revenue		20,000	
	Miscellaneous Receipts (Net):—	£		
	Rents from Hotels	5,000		
	Interest and Dividends from investments in other undertakings (details)	5,800		
	Transfer Fees	500		
	Special Items	750		
			12,050	
			270,550	
Deduct—				
	Miscellaneous Charges:—	£		
	Interest on Superannuation and other funds	1,000		
	Rent of leased and worked undertakings and guaranteed interest (details)	9,000		
	Special Items	550		
			10,550	
			£260,000	£

* This column is for figures of the previous year.

NET REVENUE ACCOUNT.

FOR THE YEAR ENDED 31ST DECEMBER, 19..

			Year 19..*
		£	£
Balance brought forward from last year's Account . . .		30,000	
Net Revenue for the Year (as per Revenue Receipts and Expenditure Account)		260,000	
Special Items		1,000	
Total		291,000	
Deduct—	£		
Interest on Debenture Stock	132,000		
Income Tax	16,000		
Interest and Discount	1,000		
		149,000	
Balance available for Dividends		142,000	
Dividends		110,000	
Balance carried forward to next year's Account . . .		£ 32,000	

*This column is for the figures of the previous year.

Accounts of Gas Companies.

The statutory forms to be used by Gas Companies under the Gas Works Clauses Act, 1871, as amended by the Gas Regulation Act, 1920, are as follows :—

(*a*) Statement of Share Capital.
(*b*) Statement of Loan Capital.
(*c*) Capital Account.
(*d*) Revenue Account.
(*e*) Profit and Loss Account (Net Revenue).
(*f*) Reserve Fund Account.
(*g*) Statement of Coals.
(*h*) Statement of Residual Products.
(*i*) General Balance Sheet.

The Capital Account and Balance Sheet are shown on page 700, while the Revenue Account shows, on the credit side, income received from the sale of gas, rent of meters, stoves, etc., proceeds of the sale of residuals, and other receipts of a similar nature ; and, on the debit side, the cost of manufacturing and distributing the gas, rent, rates, management expenses, etc.

CAPITAL ACCOUNT.

Dr. FOR THE YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	Expenditure to 31st Dec., 19..	Expended this year.	Total to 31st Dec., 19..		Capital Receipts, 31st Dec., 19...	Received during year.	Total Receipts to 31st Dec., 19..
	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.	£ s. d.
To Expenditure to 31st December, 19..				By Ordinary Shares of £ each			
Since that date.				,, Ordinary Shares of £ each			
To Lands acquired, including Law Charges				,, Preference Shares of £ each			
,, New Buildings, Manufacturing Plant, Machines, Storage Works, and other structures connected with manufacture				,, Debenture Stock			
,, New Mains and Service Pipes (not being replacements), including laying same, paving, and other works connected with distribution				,, Mortgages and Bonds			
,, New Meters (not replacements), including fixing				,, Amounts received in anticipation of Calls			
,, Cost of Promoting Special Act							
,, Special Items (if any)							
Total Expenditure							
To Balance of Capital Account							
			£				£

GENERAL BALANCE SHEET.

Dr. AS AT 31ST DECEMBER, 19.. *Cr.*

	£ s. d.		£ s. d.
To Capital Account— Balance at Credit thereof		By Cash at Bankers	
,, Profit and Loss Account— Balance at Credit thereof		,, Cash on Deposit or at Interest	
,, Reserve Fund— Balance at Credit thereof		,, Coals for Stock on hand, 31st Dec., 19..	
,, Depreciation Fund (for works on leasehold lands)— Balance at Credit thereof		,, Coke and Breeze, 31st Dec., 19..	
,, Unpaid Dividends		,, Tar and other Products, 31st Dec., 19..	
,, Interest accrued and unpaid on Mortgages, Bonds, and Debenture Stock, and other Loans, to 31st Dec., 19..		,, Sundry Stores, 31st Dec., 19....	
,, Sundry Tradesmen and others, for amount due for Coals, Stores, etc., to 31st Dec., 19..		,, Gas Meter Rental: balance of this Account due to the Company on 31st Dec., 19.. *Less* Deposits and Prepayments	
,, Wages and Contingencies— Amount due to 31st Dec., 19..		,, Coke and other Residuals, 31st Dec., 19..	
,, Other Items (if any)		,, Sundry Accounts, 31st Dec., 19..	
		,, Special Items (if any), including investments	
		£	

Accounts of Electric Lighting Companies.

The statutory forms to be used by Electric Lighting Companies under the Electric Lighting Acts, 1882 to 1909, as amended by the Electricity (Supply) Act, 1919, are as follows :—

(*a*) Statement of Share Capital.
(*b*) Statement of Loan Capital.
(*c*) Capital Account.
(*d*) Revenue Account.
(*e*) Net Revenue Account.
(*f*) Reserve Fund Account.
(*g*) Depreciation Fund Account.
(*h*) General Balance Sheet.
(*i*) Statement of Electricity Generated, Sold, etc.

The final accounts of this class of company differ from those of other statutory companies whose accounts are prepared on the "double account" system, by reason of the fact that the separate *totals* of the Capital Account, instead of the *balance* thereof, are carried to the General Balance Sheet.

The Capital Account and Balance Sheet should be in the following form :—

CAPITAL ACCOUNT.

Dr. FOR THE YEAR ENDING 31ST DECEMBER, 19.. *Cr.*

	Expenditure up to 31st Dec., 19..	Expended during year.	Total expenditure to 31st Dec., 19..		Receipts up to 31st Dec., 19..	Received during year.	Total receipts to 31st Dec., 19..
	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.	£ s. d.
To Expenditure to 31st December, 19..				By Ordinary Shares of £			
Expenditure since that date.				,, Ordinary Shares of £			
To Lands, including Law Charges incidental to acquisition				,, Preference Shares of £			
,, Buildings				,, Debenture Stock			
,, Machinery				,, Mortgages and Bonds			
,, Accumulators at Generating and Distributing Stations				,, Amounts received in anticipation of Calls			
,, Mains, including Cost of Laying the Mains				,, Sale of Patents or Patent Rights, etc.			
,, Transformers, Motors, etc.				,, Other Receipts (to be specified)			
,, Meters, and Fees for Certifying under the Act							
,, Electrical Instruments, etc.							
,, General Stores (Cables, Mains, Lamps)							
,, Purchase of Patents or Patent Rights							
,, Cost of Licence, Provisional Order, etc.							
,, Special Items							
Total Expenditure							
To Balance of Capital Account							
		£				£	

GENERAL BALANCE SHEET.

Dr. As at 31st December, 19.. *Cr.*

	£ s. d.		£ s. d.	£ s. d.
To Capital Account: Amount Received .		By Capital Account: Amount Expended		
,, Sundry Tradesmen and others, due on construction of Plant and Machinery, Fuel, Stores, etc., to 31st December, 19..		,, Stores on hand at 31st December, 19..—		
,, Sundry Creditors on Open Accounts .		Coal		
,, Net Revenue Account: Balance at credit thereof		Oils, Waste, etc. .		
,, Reserve Fund Account: Balance at credit thereof		General		
,, Depreciation Fund Account: Balance at credit thereof		,, Sundry Debtors for Amounts paid on Account of Contracts in course of completion		
		,, Preliminary Expenses . . .		
		,, Sundry Debtors for Current supplied to 31st December, 19..		
		,, Other Debtors		
		,, Cash at Bankers . .		
		,, Cash in hand . . .		
£		£		

Replacements.

The double account system is useful in that the method of presenting the accounts of certain companies is standardised, but it has the following defects:

(*a*) When a depreciation fund is not provided the renewals and replacements have to be charged against the revenue of the current year. In the earlier years when renewals are few the profits tend to be over-stated and the quoted price of the shares to increase, while in later years the heavy charges to be made tend to reduce the profits considerably and thus decrease the value of the shares. This defect is, however, often avoided by the creation of depreciation funds, etc., and it should be noted that both gas and electric lighting companies are required to provide depreciation funds in respect of leasehold works.

(*b*) Capital originally expended upon fixed assets which are subsequently abandoned remains at its original value in the accounts, while law charges incurred in promoting special Acts and similar items, such as are usually written off over a term of years in the case of an ordinary company, are permanently treated as an asset and are not written off. This defect is overcome where depreciation funds are created, by showing the cost of the asset and the amount written off separately, or by showing the original cost in italics in the Capital Account in order to comply with the statute.

It will be apparent that assets can never appear in the Receipts and Expenditure on Capital Account at *less* than cost, though they may be increased when further assets are purchased. When, therefore, assets are replaced, either with or without improve-

ments, different treatment is required to that which would be adopted in the case of a commercial concern presenting its accounts on the single accounts system.

The following methods may be adopted :—

(*a*) Charge the whole cost of replacement, less any amounts received from the sale of the old asset, to *revenue*. Any part of the old asset which is used in the construction of the new asset will be transferred from the old asset account to the new asset account.

(*b*) Estimate the present-day cost of replacing the old asset as it stands, and charge this amount, less any proceeds of sale of the old asset and the value of any materials taken from the old asset for use in the new asset, to revenue. The excess cost over the estimate will represent the cost of improvements, and this amount will be capitalised.

EXAMPLE.

A railway station is to be replaced at a cash outlay of £200,000. The original cost was £125,000, and it is estimated that the station would cost £150,000 to replace as it stands. In addition, materials to the value of £15,000 were taken from the original station and used in the construction of the new station, and £10,000 is realised from the sale of scrap. Show the amounts to charge to capital and revenue.

METHOD (*a*)

	£
Cash Cost of replacement	200,000
Less Sales of scrap	10,000
Revenue Charge	£190,000

The value of the old materials used on the new station (£15,000) will be debited to the new asset and credited to the old asset, and the capital charge will remain at its original figure of £125,000.

METHOD (*b*)

	£
Cost of replacing old station as it stands	150,000
Less Sales of scrap and materials used on new station	25,000
Revenue Charge	£125,000
Total cost of replacement	215,000
Less Cost of replacing original station	150,000
Capital Charge	£65,000

£65,000 thus represents the cost of the improvements effected and will increase the total capital charge from £125,000 to £190,000.

Generally, method (*b*) is to be preferred to method (*a*), as the capitalisation of improvements follows sound commercial practice.

Where a Depreciation Fund has been built up, the Revenue charge would be debited thereto, any excess debit being written off to Revenue Account. Any credit balance remaining on Depreciation Fund Account would be carried forward.

THE ACCOUNTS OF BANKING COMPANIES

The main function of a banker is the exchange of rights to the possession of money, and the exchange of money for credit, and credit for money, but in addition he acts as agent of his customer for various purposes.

His duties include—

THE RECEIPT OF DEPOSITS—

(a) *On Current Account*, on which no interest is generally paid, withdrawable by cheque on demand.

(b) *On Deposit Account*, which bear interest, varying with the notice required for withdrawals.

DISCOUNTING BILLS at market rates. This gives the customer immediate use of capital and a speedy turnover, and the banker obtains a secure investment for his surplus funds, which can be turned into cash at will.

GRANTING LOANS to customers against various forms of security either on current or loan account. Interest is paid by the customer at settled rates, and due notice is required for repayment.

ACTING AS AGENT FOR HIS CUSTOMERS AND FOR OTHER BANKS.

(a) For the safe custody of valuables.

(b) For the collection and payment of coupons and dividends.

(c) For stock and share transactions.

(d) Acting in various other capacities, such as that of trustee, attorney, executor, etc.

(e) Acting as clearing agent, London agent, correspondent, etc., of other banks.

THE ISSUE OF NOTES. This is now confined to the Bank of England, all private banks having ceased to issue, and it is a relatively unimportant function of modern English banking. In Scotland and Ireland, however, all the banks issue notes from £1 upwards, and for a time after the outbreak of the war of 1914 to 1918 these notes were made legal tender in the respective countries.

These varied functions necessitate a highly specialised system of book-keeping, of which a detailed consideration is beyond the scope of this volume, and only a general outline of the principal features of bank accounts can be given.

The "Slip" System of Posting.

Owing to the special nature of a banker's transactions it is necessary that he should be able to ascertain, at any moment during the day, the exact position of a customer's account. The ordinary method of posting from subsidiary books would be useless in these circumstances, and the "slip system" is largely used (see pages 596 and 597). All payments in by customers are

accompanied by a paying-in slip; similarly, payments out are made upon cheques drawn by customers; and these original documents are used for the purpose of posting to the ledger. Items that would in the ordinary way be entered in a journal and posted therefrom, are recorded upon *debit* and *credit slips*, and posted direct to the ledger. Debit slips are used when it becomes necessary to debit a customer with charges for collection, commission, transfers to deposit account, interest charged, etc., while credit slips are used for credits to customers, bills discounted, proceeds of securities sold, transfers from deposit accounts, interest allowed, etc. The following are specimen slips:—

DEBIT SLIP.

No.

MIDLAND BANK, LIMITED.

May 31, 19...

Debit J. Wood, Current Account, for transfer to Deposit Account.

£250–0–0

A. B. C.,
Accountant.

Current $^{a}/_{c}$ Fo.

CREDIT SLIP.

No.

MIDLAND BANK, LIMITED.

May 31, 19...

Credit J. Wood, Deposit Account, transfer from Current Account.

£250–0–0.

A. B. C.,
Accountant.

Deposit $^{a}/_{c}$ Fo.

The above slips record a transfer of £250 from Current Account to Deposit Account. The two slips combined constitute a Journal entry which in the ordinary way would be made as follows:—

JOURNAL.

		Dr.	*Cr.*
19..		£	£
May 31	J. Wood. Current Account. . . . . . *Dr.*	250	
	To J. Wood Deposit Account		250
	Being transfer of £250 from Current Account to Deposit Account.		

By utilising cheques, paying-in slips, and debit and credit slips as posting media, items can be posted almost as quickly as the transactions occur. Labour is saved, and the work is distributed in a manner that would be impossible if the usual books of original entry were employed.

The Account Books used by a Banker.

As the principal transactions of a banker involve the receipt or payment of money, the system used is actually an elaborate analysis of cash transactions. The receipts will include coin, treasury and bank notes, cheques, etc., paid into deposit or current accounts, commissions and interest earned, etc., while the payments will consist of amounts paid out of current and deposit accounts, loans, interest, and the general expenses of management.

The usual books required to record these transactions are indicated in the following paragraphs * :—

CASH RECEIVED. All cheques, notes and coin paid in by customers are recorded on paying-in slips, which are stamped by the cashier, the customer retaining the counterfoil. The cashier enters the receipts in a Counter Cash Book (or Received Cash Book), which is ruled as shown below :—

COUNTER CASH BOOK.

Money.			Notes.	Date.	Name.	Total Credit.		
£	s.	d.		19..		£	s.	d.
12	0	0		Jan. 1	J. Stewart . . .	112	0	0
			4/5	"	H. Burton . . .	20	0	0
			421626/9	"	G. Harrison . . .	30	0	0

Note.—The above entries represent payments in by Stewart of £112, i.e., £12 in cash and £100 in cheques; Burton, £20 in £5 bank notes; and Harrison, £30 solely in cheques. The cheques received are included in the total column but are not recorded in the analysis columns.

The cashier places in his till all coin and Treasury notes received by him, and passes on to a "waste-book" clerk, seated behind him, the bank notes and cheques, attached to the original paying-in slips.

RECEIVED WASTE BOOK (or RECEIVED DAY BOOK). This book contains a classified record of all cheques, bank notes, etc., paid in by customers. The ruling is as shown on page 707. The notes are listed and subsequently paid into the bank's account at the Bank of England; the cheques are passed on to the clearing department for presentation at the clearing house, in the case of cheques drawn on clearing banks, or at the bank upon which they are drawn in the case of cheques drawn on non-clearing banks

* There is no uniform accounting system for all banks and the system outlined in this chapter is subject to modification and variation in the case of certain banks.

(i.e., " walks " cheques). The customer's paying-in slip is handed to the ledger department for posting to the credit side of the customer's account.

RECEIVED WASTE BOOK.

Name.	Total Amount.	Town Clearing.	Metropolitan Clearing.	Country Cheques.	Walks.	Bank of England Cheques.	Bank and Country Notes.	Money.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
J. Stewart .	112 0 0	25 0 0	30 10 0		44 10 0			12 0 0
H. Burton .	20 0 0						20 0 0	
G. Harrison	30 0 0	5 0 0	15 0 0	10 0 0				

Note.—The amounts paid in by Stewart, Burton and Harrison, and entered in the Counter Cash Book, are shown above as recorded in the Received Waste Book, the cheques being classified according to the different clearings and "walks" (i.e., non-clearing bankers' cheques).

The Waste Book is thus an analytical Cash Received Book, and also serves as a check on the receiving cashier.

The Clearing House. This is an association of the leading banks and facilitates the collection and payment of cheques paid in by customers and drawn upon other banks. The cheques received by the bank head offices in London from their branches and city offices are sorted and listed, and are taken to the clearing house each day. The lists are totalled and at the end of the day a balance is struck, and each bank receives payment of the net amount due to it by all the other clearing banks by means of a draft on the Clearing Bankers' Account at the Bank of England, or makes a payment in a similar way of the net amount owing by it to the other banks. The clearings are divided into Town, Metropolitan, and Country according to whether the branch bank on which the cheque is drawn clears through the Town, Metropolitan, or Country Clearing sections of the London Clearing House. Cheques on non-clearing banks, or banks without clearing agents, go to the "walks" department for collection by the " walks " clerks.

Local clearing houses for the collection of cheques, etc., drawn on local banks exist in various large towns, such as Birmingham and Manchester.

Cash Paid. When payment of cheques drawn is made over the counter, the paying cashier enters particulars in a Paying Cashier's Counter Cash Book, a specimen of which is shown on the following page :—

COUNTER CASH BOOK (PAYING CASHIER).

Total.	Name.	Numbers of Bank Notes.	Amount of Bank Notes.	Money.
£ s. d.			£ s. d.	£ s. d.
10 0 0	B. Astill . . .	2/5 42653/4	10 0 0	
20 0 0	D. Grayson . .			20 0 0
100 0 0	C. Ford . . .	5/10 44678/82	50 0 0	50 0 0

The cheques are then handed to the ledger department for debiting to the respective customers' accounts.

Paid Waste Book. This records the cheques paid through the clearing house, etc., and also cheques credited to the accounts of other customers of the same bank. These cheques also are ultimately passed to the ledger clerks and debited to the accounts of the customers by whom they were drawn.

Daily Balance. At the end of each day the receiving and paying cashiers agree the money in their tills with the figures arrived at by taking the opening balances of cash in hand, plus money paid in, and less money paid over the counter, as recorded in the Counter Cash Books.

The Received and Paid Waste Books are summarised daily, and the totals entered in a General Cash Book, a simple form of which is shown below. It should be noted that this book forms in effect one continuous journal entry, in totals, for the whole of the day's transactions, the totals being posted to the General Ledger.

Dr. GENERAL CASH BOOK. *Cr.*

	£	s.	d.		£	s.	d.
To Current Accounts, paid in	150,006	10	0	By Current Accounts, cheques paid .	110,610	10	0
„ Deposit Accounts, do.	10,000	0	0	„ Deposit Accounts, withdrawals . .	4,000	0	0
„ Bills Discounted . .	52,100	0	0	„ Loans to Customers .	95,000	0	0
„ Customers' Loans, paid off . . .	3,500	0	0	„ Acceptances, bills accepted . .	60,000	0	0
„ Bills Payable, bills accepted . .	60,000	0	0	„ Bills Payable, acceptances due . .	80,000	0	0
„ Acceptances, acceptances due . .	80,000	0	0	„ Clearing, Bank of England . . .	15,012	10	0
„ Cheque Stamps . .	5	16	8	„ General Expenses .	224	10	0
„ Interest Received . .	520	0	0				
„ Commissions . .	125	0	0				
Total. .	£356,257	6	8	Total . . .	£364,847	10	0
To Balance from previous day . . .	22,212	10	0	By Balance to succeeding day . . .	13,622	6	8
	£378,469	16	8		£378,469	16	8

GENERAL LEDGER. This is the most important book kept by a bank, and contains accounts for all the assets and liabilities, profits and losses of the bank. The General Ledger is consequently self-balancing, and a Profit and Loss Account can be prepared from the particulars contained in this ledger. Totals only appear in the General Ledger, the necessary details appearing in various subsidiary ledgers and registers. The total of the balances on each subsidiary ledger or group of ledgers must agree with the balance on the corresponding ledger account in the General Ledger.

Thus, to take an example, there will be a Current Account in the General Ledger. This account will be debited daily with the total of withdrawals by customers on current account, and credited with the total amounts paid in, the corresponding entries appearing in the General Cash Book, as shown on page 708.

As previously explained, each individual customer's Current Account (in the Current Account Ledger) will have been written up *in detail* from the paying-in slips, cheques drawn, and debit and credit slips. It is clear, therefore, that the Current Account in the General Ledger acts as a total account in respect of the Current Accounts Ledger (or Ledgers), and the balance of this total account at any time equals the totals of the individual balances on the Current Accounts Ledger.

In a similar manner, Deposit Accounts, Investments, Loans, Bills Discounted, etc., are each represented by one total account in the General Ledger, the necessary details being recorded in separate Deposit Account Ledgers, Investment Ledgers, etc.

The following illustrations show specimen forms of the Current Account, i.e., Total Account in the General Ledger and an individual customer's account in the Current Account Ledger.

GENERAL LEDGER

CURRENT ACCOUNTS.

DATE.	DR.	CR.	BALANCE. CR.
19..	£ s. d.	£ s. d.	£ s. d.
Dec. 31		122,610,515 4 6	122,610,515 4 6
19..			
Jan. 1	2,620,613 10 0	4,626,843 10 0	124,616,745 4 6
„ 2	3,576,823 5 0	5,796,653 0 0	126,836,574 19 6
„ 3	2,876,134 5 0	6,543,828 13 6	130,504,269 8 0

Note.—This account will be balanced off monthly, quarterly, or half-yearly, according to the practice of the bank concerned. Totals are posted from the General Cash Book. A column for particulars is unnecessary and is usually omitted.

CURRENT ACCOUNT LEDGER.

B. ASTILL, 55 SOUTHAMPTON ROW, W.C.

Date.	Details.	Dr.	Cr.	Balance Cr.
		£ s. d.	£ s. d.	£ s. d.
19.. Dec. 31	By Balance		225 0 0	225 0 0
19.. Jan. 1	To P. 21634. Jones . . .	5 5 0		219 15 0
„ 2	„ „ 21637. Brown . . .	4 4 0		215 11 0
„ 2	„ „ 21635. Self . . .	10 0 0		205 11 0
„ 2	„ „ 21636. Self . . .	5 0 0		200 11 0
„ 3	By Cash		2 10 0	203 1 0
„ 4	To P. 21638. Harvey . .	20 0 0		183 1 0
	„ Cheque Book. Debit Note 1257	16 8		182 4 4

Note.—This account will be balanced off quarterly or half-yearly. The balance standing on this account at any time is shown in the third money column, as it is, of course, essential that the banker should know the exact state of the account in order to prevent the customer overdrawing his account without permission. Where interest is allowed on current accounts, additional columns are inserted to provide for the calculation of interest on the day to day balance by means of the " products " method.

Loans.

Loans made to customers, and the interest thereon, are credited in the General Cash Book, and debited in total to a Loans Account in the General Ledger. A Loans Ledger is also kept, and the postings made from debit slips to the individual customer's loan accounts.

Bills Discounted.

As previously explained a banker derives a considerable proportion of his profits from the discounting of Bills of Exchange on behalf of customers of good financial standing. In making his book-keeping entries, the banker debits the daily total of the face values of bills discounted to Bills Discounted Account in the General Ledger, and credits the discount deducted to Discount Account, the contra entries appearing in the General Cash Book. When the bills mature, General Cash Book is debited, and Bills Discounted Account credited with the total bills due each day. The banker also records details of bills discounted in the following memorandum books, *viz.*,

(*a*) *Bills Received for Discount Register.* This contains full details as to drawer, acceptor, date and tenor of bill, etc.

(*b*) *Bills Discounted Ledger.* This ledger contains an account in respect of each customer on whose behalf bills are discounted. It is written up from posting " slips," and agrees in total with the Bills Discounted Account in the General Ledger.

(*c*) *Bills Discounted Diary.* The bills discounted are

entered in this book under their due dates, so that by referring to this book daily, all bills due can be ascertained, and promptly passed forward for presentation.

It will thus be seen that the same bills are classified, in the Bill Diary in the order of their due dates, and in the Bill Ledger under the name of their respective owners.

Acceptances.

Banks very frequently accept bills on behalf of their customers, charging a commission for the accommodation, the customers undertaking to provide the bank with the necessary funds to meet the bills upon maturity. These bills are entered in memorandum books and registers, in a similar manner to bills discounted, i.e., Acceptance Register, Acceptance Diary, and memorandum Acceptance Ledger. The total of the bills accepted is credited daily to an account headed " Acceptances on Behalf of Customers " in the General Ledger, representing the bank's liability on the bills accepted, and debited to an account called " Liabilities of Customers for Acceptances, etc.," which shows the contra aspect, i.e., the liability of the customer to place the banker in funds upon maturity of the bill.

Pass Books.

These are issued to all customers having Current or Deposit Accounts with the bank and enable the customer to review the state of his account at the bank. They constitute a copy of the customer's account in the Current or Deposit Account Ledgers, i.e., payments in are credited, and payments out are debited. Thus in this case the pass book corresponds very closely to the account of the customer in the bank's ledger. The pass books issued by some banks, however, represent the bank's account as it appears in the customer's own ledger, the debit and credit items appearing on reverse sides. In the former case the pass book is headed " ——, Esq., in account with the —— Bank," while in the latter case the heading is shown as " The —— Bank in account with ——, Esq."

Generally, the Pass Books are written up from the original documents (cheques, paying-in slips, debit and credit slips) after these have been dealt with by the ledger clerks. When all the entries have been made the totals of the two sides should be agreed with the relative totals in the ledger account, and the balance between the totals agreed with that in the ledger by a responsible clerk.

Many Pass Books are now issued in loose leaf form and are compiled by machines, the debits, credits and daily balances being set out in columnar form. A specimen ruling appears on page 68.

Final Accounts.

The Profit and Loss Accounts of banks are compiled on the same principles as those of ordinary commercial companies, viz., expenditure and losses are debited and income and profits are credited. An example is given on page 714, and it will be seen that most of the items are self-explanatory. When studying this example it should be noted that the Profit and Loss Account given is the *published* form of account in which details are considerably curtailed. A brief explanation is also appended of items usually appearing in Bank Balance Sheets.

The provisions of the Companies Act, 1929, apply to banking companies, and the practical example given on pages 714 and 715 should be studied with particular regard to the methods adopted in order to comply with the Act as regards disclosure in Balance Sheets.

LIABILITIES. The items under this heading are the amounts owing by the bank to its customers and shareholders, together with the undivided balance to the credit of Profit and Loss Account.

Capital Paid Up is the actual amount of money received from shareholders for shares issued to them. It should be noted that most English joint-stock banks have established a "reserve capital" by setting aside part of the uncalled capital for use only in the event of the liquidation of the bank, thus materially strengthening the security available for the bank's depositors.

Reserve Fund is an accumulation of undivided profits and of appropriations specially made to provide against unforeseen contingencies of any kind.

Current, etc., Accounts. This is the total amount owing by the bank to its customers and correspondents for deposits of all kinds, on current or deposit account.

Acceptances, etc., on behalf of Customers. Under this heading is entered the total amount of the bank's liability on its signature as endorser or acceptor of bills on behalf of its customers and agents. As the bank is able to fall back on its customers if necessary, a corresponding entry appears on the assets side.

Rebate on Bills not Due. This is a reserve for the unexpired portion of discount charged. At the date of the Balance Sheet a number of the bills discounted by the banker will not have matured, and consequently, all the discount charged will not have been earned. The amount unearned, i.e., the amount from the date of the Balance Sheet to the dates of the maturity of the bills unpaid, will be calculated, debited to the Profit and Loss Account and shown in the Balance Sheet as a reserve.

ASSETS. On this side appear the values of the cash, investments and property held by the bank against its liabilities. The

assets are always arranged in order of realisability, so that customers and others interested in the concern can estimate the strength and stability of the bank at a glance by observing the proportion of liquid assets maintained by the management.

Cash in hand represents the amount of cash, including coin and notes, held by the bank at its head office and branches, and also the balance of the bank's account at the Bank of England, which is treated as cash. No profit is earned on this item.

Money at Call and Short Notice is surplus money lent by the bank to bill brokers and stock brokers at a low rate of interest, withdrawable at call or at very short notice. The money is often lent overnight, from one day to the next, or at seven days' notice. The loans are secured by the deposit with the bank of first-class bills or other securities.

Bills Discounted. This represents the bills of exchange which have been discounted by the bank for its customers, and also the investments of the bank in bills which it has itself purchased in the open market.

Investments are chiefly British and Colonial Government securities, railway debentures, local loans, etc., all of which are held more or less permanently, and interest is earned thereon. The portion of the investments "lodged for public accounts" is specially earmarked as security for the due repayment of public funds lodged with the bank on the deposit and current accounts of Government departments and local authorities.

Advances to Customers. This amount is the total owing to the bank by its customers and agents, on overdrafts and loans, and is secured by deposit of title deeds, share certificates, life policies, etc. Interest is paid at varying rates, and forms the bulk of the bank's profits.

Bank Premises. The value of these is generally included at a much reduced figure, although the premises of many banks are extremely valuable. The buildings are, however, difficult to realise in times of stress.

Book-keeping by Machinery.

In Chapter XIV. we have considered the general features of machine aids to book-keeping, and it now remains to note their application to the accounting system of the banks, which in recent years have been making a greatly increased use of book-keeping machinery in order to effect economies in clerical labour and floor space.

THE X. Y. Z. BANK

BALANCE

AS AT 31ST

Liabilities.

	£	s.	d.	£	s.	d.
Share Capital Authorised :—						
2,869,079 Shares of £12 each				34,428,948	0	0
2,000,000 Shares of £2 10s. each				5,000,000	0	0
5,771,052 Shares of £1 each				5,771,052	0	0
				£45,200,000	0	0
Share Capital Issued :—						
2,869,079 Shares of £12 each, £2 10s. paid	7,172,697	10	0			
1,921,677 Shares of £2 10s. each, fully paid	4,804,192	10	0			
1,456,078 Shares of £1 each, fully paid	1,456,078	0	0			
				13,432,968	0	0
Reserve Fund				13,432,968	0	0
Dividend payable on 1st February 19..				614,483	11	3
Balance of Profit and Loss Account, as below				859,258	0	2
				28,339,677	11	5
Current, Deposit and other Accounts (Including £271,051 5 0 on Public and other Accounts secured as per contra)	376,703,192	19	10			
Balances due to Affiliated Companies	3,272,254	16	3			
				379,975,447	16	1
Acceptances and Confirmed Credits on account of Customers				19,779,217	16	3
Engagements on account of Customers				17,695,148	8	7
The Bank has contracts running for the sale of Foreign Currencies to the value of £4,799,983 2s. 7d. which are covered by purchases to a corresponding amount.						
The total sum paid to Directors as remuneration for their services is as follows :—						
Fees and Income Tax thereon paid by the Bank	44,301	19	0			
Fees and Income Tax thereon paid by Affiliated Companies to such Directors of those Companies as were also Directors of the Bank	6,714	13	1			
Total	£51,016	12	1			
				£445,789,491	12	4

Dr. **PROFIT AND LOSS ACCOUNT FOR THE**

	£	s.	d.
To Interim Dividend at the rate of 18 per cent. per annum, less Income Tax, paid 15th July, 19..	614,483	11	3
,, Dividend at the rate of 18 per cent. per annum, less Income Tax, payable 1st February, 19..	614,483	11	3
,, Bank Premises Redemption Fund	500,000	0	0
,, Officers' Pension Fund	220,000	0	0
,, Balance carried forward to next Account	859,258	0	2
	£2,808,225	2	8

.... *Chairman.*

REPORT OF THE AUDITORS TO THE

In accordance with the provisions of Sub-section 1 of Section 134 of the Companies Act, 1929, we

We have examined the above Balance Sheet in detail with the Books at Head Office and with the Notes and Balances with the Bank of England, Balances with, and Cheques in course of Collection on Money at Call and Short Notice. We have also verified the Securities representing the Investments of that such Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the shown by the books of the Company.

LONDON, 11*th January*, 19..

LIMITED

SHEET.

.DECEMBER 19..

Assets.

	£	s.	d.
Coin, Bank Notes and Balances with the Bank of England	46,918,242	13	10
Balances with, and Cheques in course of Collection on other Banks in Great Britain and Ireland	18,375,201	16	8
Money at Call and Short Notice	21,670,909	7	8
Investments at or under Market Value :—			
War Loan and other British Government Securities (of which £425,436 5s. is lodged for Public and other Accounts)	31,798,351	5	8
British Corporation Stocks	249,497	16	5
Colonial and Foreign Government Stocks and Bonds	169,855	14	7
Sundry Investments	711,185	13	7
Bills Discounted	58,783,656	14	11
	178,676,901	3	4
Advances to Customers and other Accounts	210,374,230	1	1
The X. Y. Z. Bank Executor & Trustee Company Limited :— Loans on behalf of Clients	164,444	0	6
The A. B. Banking Company Limited :— Government of Northern Ireland Guaranteed Loans Account	1,800,000	0	0
Liabilities of Customers for Acceptances, Confirmed Credits and Engagements	37,474,366	4	10
Bank Premises at Head Office and Branches, at cost less amount written off	8,964,535	7	3
Other Properties and Work in Progress for extension of the business, at cost less amount written off	1,213,349	5	9
Shares in Affiliated Companies :—			
The A. B. Banking Company Limited :— 200,000 Shares of £12 10s. each, £3 10s. paid Reserve and Undivided Profits	1,448,108	2	0
The C. D. Bank Limited :— 100,000 Shares of £50 each, £10 paid; 30,000 Shares of £10 each, fully paid; Reserve and Undivided Profits	2,940,054	5	5
The E. F. Bank Limited :— 163,000 Shares of £20 each, £7 paid; Reserve and Undivided Profits	2,356,655	5	6
X. Y. Z. Bank Executor & Trustee Company Limited :— 200,000 Shares of £5 each, £1 paid; Reserve and Undivided Profits.	376,847	16	8
	£445,789,491	12	4

YEAR ENDED 31ST DECEMBER, 19.. *Cr.*

	£	s.	d.
By Balance from last Account	848.563	6	7
,, Net Profit for the year ended 31st December, 19.., including the sum of £421,104 dividends from the Affiliated Companies, full provision having been made for Rebate, Expenses, and all Bad and Doubtful Debts	1,959,661	16	1
	£2,808,225	2	8

.... } *Deputy*
.... } *Chairmen.*
.... *Director.*

.........., *Managing Director.*

MEMBERS OF THE X. Y. Z. BANK LIMITED.

report as follows :—

certified Returns from the Branches. We have satisfied ourselves as to the correctness of the Coin, Bank other Banks in Great Britain and Ireland and Bills Discounted, and have verified the correctness of the the Bank, and having obtained all the information and explanations we have required, we are of opinion Company's affairs according to the best of our information and the explanations given to us and as

.... CHARTERED ACCOUNTANTS, *Auditors.*

Before the installation of book-keeping machines, it is first necessary to place the ledgers on a loose-leaf basis and to replace the pass-books by loose-leaf statements. The ledger accounts and the statements are prepared directly and independently from the cheques, debit slips, paying-in slips, etc., so that the statements form a check on the ledger. The vouchers are totalled automatically as they are posted to the Current Accounts, and the totals thus obtained are used for posting to the General Cash Book from which the General Ledger is written up. This is, of course, only an outline of the operations involved in keeping the Current Accounts, but the modifications required for other kinds of business, i.e., Deposit Accounts, Loans, etc., are only slight.

The *modus operandi* of a typical book-keeping machine used in the posting of Current Account sheets and pass-book sheets or statements is as follows :—

The vouchers (i.e., cheques, paying-in slips, etc.) are sorted and the required sheet is placed in the machine, which itself adjusts the sheet into the correct printing position. The balance is then printed into an " Old Balance " column, and the machine automatically moves into position for debit or credit entries. When moving into the debit position the machine is automatically set to subtract, and all that has to be done is to list the debit items. The machine then moves into position for the credit items and becomes set for adding. After the credits are listed, the machine is moved to the " New Balance " column, where it prints the new balance on the pressure of a key. Lastly, the sheet is ejected by the machine and is replaced in its permanent receptacle. If the result of the postings is an overdraft, the machine will not register the new balance until the clerk makes a special adjustment. He is therefore made aware of the debit balance, and when this is finally printed it is automatically marked " OD " or " DR " by the machine.

The machine, while it has been arriving at the new balance, has also totalled the debits, totalled the credits, and produced a " Tally Roll " which gives a complete history of every entry made.

The total of debits and credits posted to each ledger can be transferred into a Control Book which must agree with the figures already obtained for the General Ledger from the Waste Book Summary, and this agreement will prove that all debits and credits have been correctly posted.

The statements, i.e., the bank pass-book sheets, are made up independently from the original vouchers. The totals of debits and credits are compared with those obtained by the ledger clerk, and if they agree, as they should, the two Tally Rolls are placed side by side. This comparison provides a check on the entries but does not prove that all the items have gone to the

correct accounts. In order to check this, the statements are compared with the current account before being handed over to the customer, and if the individual balances agree, this can be considered as conclusive proof of the correctness of both, as it is unlikely that clerks working independently will make the same mistake.

Under such a system as that described above, periodical statements can be regularly sent to customers, who no longer need submit their pass books to obtain an up-to-date account.

EXERCISE 17.

A. (*a*) What undertakings are compelled (by Statute) to adopt the Double Account System ?

(*b*) In the case of the acquisition of new equipment in order to replace discarded equipment, what is the difference in treatment under the Double Account System and under the Single Account or Ordinary Commercial System ?

B. (*a*) Where is the main difference to be found between accounts presented under the Double Account System and those presented on the Single Account System ?

(*b*) What is the actual result of the treatment of the cost of repairing wastage under the Double Account System ? Compare this with the practice under the Single Account System.

C. Describe the differences, if any, in the method of presenting the Balance Sheets of Companies whose accounts are kept :—

(*a*) On the Single Account System.
(*b*) On the Double Account System.

D. The expenditure on Capital Account of the L. C. Water Company to 30th June, 19. ., was as follows :—

	£
Plant	235,421
Furniture	220
Tools, etc.	280
Meters	4,530

and the receipts on Capital Account were

	£
Ordinary Shares	140,000
Preference Shares	75,000
Debenture Stock	30,000

During the following year the receipts and payments on Capital Account were : Ordinary Shares, £10,000 ; Preference Shares, £5,000 ; Plant, £9,540 ; Meters, £240 ; Property, £9,769.

Compile a Capital Account on the Double Account System.

E. The following are the balances of the General Railway Company for the half-year ended 31st December, 1940. Prepare in the prescribed form

(1) Capital Account, (2) Revenue Account, (3) Net Revenue Account, (4) General Balance Sheet :—

	£	£
Mortgage Debenture Interest	30,000	
" " " accrued		11,400
Prior Lien Debenture Interest	14,000	
" " " accrued		3,600
Cash at Bankers and in hand—		
London	11,000	
Abroad	4,000	
Interest received		35
Investments	25,000	
Loss on Exchange	3,000	
Income Tax	2,200	
Miscellaneous Receipts		150
Passenger Receipts		22,000
Freight, Storage, etc.		71,000
Steamboat Service		2,400
General Reserve Account		2,000
Special Trains		1,500
Renewal of Plant Reserve Account		2,000
Traffic Expenses	16,000	
Maintenance of Way, Works, etc.	8,000	
Transfer Fees		50
Capital Receipts (Share and Debenture)		1,463,000
Locomotive Power	10,000	
Capital Expenditure to 30th June, 1940	1,400,000	
Do. Half-year ended 31st December, 1940	27,000	
Government Subsidy for half-year ended 31st December, 1940		24,000
Repairs and Renewals of Carriages and Wagons	1,900	
Remuneration of Trustees for Debenture holders	400	
Compensations	200	
General Charges	12,000	
Net Revenue Account, balance 30th June, 1940		6,065
Dividend Account—Balance of Dividend paid for half-year ended 30th June, 1940	5,000	
Stores on hand and in transit, 31st December, 1940	25,000	
Interest and Discount	1,000	
Bills Receivable	3,000	
Bills Payable		2,850
Sundry Debtors, London	8,000	
" Abroad	15,500	
Sundry Creditors, London		2,000
" Abroad		8,000
Unclaimed Interest		150
	£1,622,200	£1,622,200

F. The following particulars relate to the Northern Banking Company Limited. You are required to draft the Balance Sheet, using imaginary figures :—

Money at Call and Short Notice.
Bills Discounted.
Advances to Customers.

Reserve Fund.
Capital Paid Up.
Investments at or under market value.
Liabilities of Customers for Acceptances and Engagements.
Coin, Bank and Currency Notes and Balances with Bank of England.
Current, Deposit and other Accounts.
Balance of Profit and Loss Account available for distribution.
Balances with and Cheques in course of collection on other Banks in the United Kingdom.
Bank Premises at Head Office and Branches at cost less amounts written off.

G. Frame a Balance Sheet from the following figures extracted from the books of the South of England Banking Company, Limited, as at 31st December, 19.. :—

	£	s.	d.
Coin, Bank and Currency Notes and Balances with the Bank of England	59,989,012	4	8
Bills Discounted	72,118,033	17	8
Investments at or under market value	56,758,808	9	10
Capital Paid up, viz. :—			
2,869,079 Shares of £12 each, £2 10s. paid	7,172,697	10	0
1,475,262 Shares of £2 10s. each fully paid	3,688,155	0	0
Balances with and Cheques in course of Collection on other Banks in the United Kingdom	12,802,707	1	7
Reserve Fund	10,860,852	10	0
Money at Call and Short Notice	11,651,496	13	10
Balance of Profit and Loss Account available for distribution	1,461,487	1	10
Advances to Customers and other Accounts	176,779,261	9	8
Liabilities of Customers for Acceptances and Engagements	19,848,321	11	2
Current, Deposit and other Accounts	375,117,092	4	6
Bank Premises at Head Office and Branches at cost less depreciation	4,942,299	9	1
Shares in A. and B. Banking Companies, Limited (affiliated to the South of England Banking Company, Limited) at cost	3,258,665	0	0
Acceptances and Engagements on account of Customers	19,848,321	11	2

H. Draw up a bank balance sheet approximating to that of any London Clearing Bank, and give a short explanation of the items occurring in it.

I. Give a brief outline of the "slip" system of posting as applied to the accounts of a bank.

J. From the following particulars draw up (1) Balance Sheet of a company as on 30th June, 1941, on the Single Account System; and (2) the Capital Account and General Balance Sheet as on the same date on the Double Account System.

Nominal Capital, £300,000; Issued Capital, £260,000; 5% Debentures, £40,000; Trade Creditors, £16,000; Reserve Fund, £15,000; Trade Debtors, £38,000; Cash at Bank, £35,000; Investments (reserve), £15,000; Stock, £24,000; Profit and Loss Account, £16,000.

Expenditure to 30th June, 1940.—Land, £12,000; Shafting, etc., £135,000; Machinery, £40,000; Buildings, £13,000. The expenditure during the year to 30th June, 1941, was £25,000, £25,000 and £10,000 on the last three items, and a Depreciation Fund of £25,000 had been created.

K. The following items represent the position of a Bank on 31st December, 1940, and the whole of its transactions during 1941.

Open up necessary accounts and prepare a Balance Sheet at 31st December, 1941:—

		£
Capital paid up, 31st December, 1940		500,000
Balance of Profit and Loss Account, 31st December, 1940		9,756
Liabilities to Customers on Current Accounts		325,000
Liabilities to Customers on Deposit Accounts		236,500
Advances on Current Accounts and Loans		688,606
Bills of Exchange in Hand		157,650
Investments		150,000
Cash in Hand		25,000
Cash at Call and Short Notice		50,000
Cash paid in by Customers on Current Accounts		2,500,000
Cash paid out to Customers on Current Accounts		2,440,000
Cash paid in by Depositors		755,000
Cash paid out to Depositors		677,000
Bills Receivable—Discounted	£300,000	
Less Discount charged thereon	10,500	
		289,500
Cash paid out on Bills Discounted	10,000	
Balance credited to Customers' Current Accounts	279,500	
		289,500

It may be assumed that apart from the assets and liabilities in which transactions have taken place during the year, the remaining Balance Sheet items are identical with the balances thereof as at the commencement of the year.

CHAPTER XVIII

INSURANCE COMPANIES' ACCOUNTS; BUILDING SOCIETIES' ACCOUNTS

A DISTINCTION is sometimes observed in the usage of the terms "Assurance" and "Insurance," the former being practically confined to Life Assurance business (including endowment assurance and annuities), whilst the latter term is used to denote insurance contracts covering events which may or may not happen, such as fire, burglary, accident, etc. Although, in practice, this distinction is not rigidly adhered to, a contract of assurance may be said to be one made between two parties (assurer and assured), which guarantees payment of the sum assured by the assurer to the assured upon the happening of a certain event dependent upon human life. Such a contract is not one of indemnity. A contract of insurance contemplates the granting of certain payments or benefits, by the insurer to the insured, consequent upon the happening of certain events, stipulated in the contract, which events are not expected, but which may happen. It is, therefore, a contract of indemnity against a contingency, e.g., a Comprehensive Motor Car policy granting protection against *probable* accidents and *possible* legal liability arising therefrom. The assurance or insurance contract is evidenced by a document termed the "Policy."

Classes of Assurance Companies and Policies.

Life assurance companies may be divided into two main classes, viz.:—

(1) PROPRIETARY COMPANIES, the capital of which is subscribed by shareholders, who are entitled to receive the surplus or divisible profits in the form of dividends as are shareholders in other companies. All or part of the profits on "with profit" policies belong to that class of policy-holder, the shareholder portion being the surplus on the non-profit class together with the balance (if any, allowed by the Articles of Association, etc.) of the profits on the "with profit" policies.

(2) MUTUAL COMPANIES, formed by the policy-holders themselves, and the capital of which is, in the first instance, composed of the original premiums of the earliest policy-holders. The whole of the

surplus is available for distribution amongst the "with profit" policy-holders.

The policies issued are divisible into two main classes, viz., "With Profit" and "Without Profit" policies. The former type of policy, in addition to safeguarding the principal sum assured, confers the right to participate in the company's bonus distributions. "Without Profit" policies confer no such right, and the amount payable is restricted to the sum specified in the policy. The premiums payable for "with profit" policies are naturally fixed on a higher scale than those for "without profit" policies.

All contracts of insurance or assurance are known as contracts, "*uberrimæ fidei*," i.e., "of the utmost good faith," and this means that the contract will be void and of no effect unless the proposer discloses to the company every material fact of which he has knowledge, and which may affect the insurance. Similarly, the insurer must exhibit the utmost good faith in his dealings with the insured. Moreover, the proposer must have an *insurable interest*, i.e., some pecuniary interest at the time the policy is taken out in the life of the person assured or other subject-matter of the insurance.

Where large amounts are insured, insurance companies customarily reinsure part of the risk undertaken; that is, the company which undertakes the risk in the first instance pays to another company a premium for the right to recover part of the original sum assured as and when a claim occurs. Such reinsurance contracts are quite distinct and separate from the original insurance, and any rights accruing under the reinsurance policy vest only in those companies who are parties to the reinsurance contract; the original person insured has no rights under it.

It is a common practice for insurance companies to transact various classes of business, e.g., fire, life, accident, and marine business, and such companies are often termed "composite companies" as distinct from those companies which transact one class of business only. Those companies, other than life assurance companies, which combine for the fixing of rates for the risks undertaken are known as *tariff companies* or offices.

Premiums.

In order to effect an insurance the proposer first of all completes a proposal form which becomes the basis of the contract between the parties. The amount payable by the assured on acceptance by the company of the proposal is known as the "first premium," subsequent premiums being termed "renewal premiums." Usually; life assurance premiums are payable yearly in advance, but monthly, quarterly or half-yearly premiums may be arranged at slightly extra cost. In the case of

a class of life assurance known as "Industrial Assurance," in which the sums assured are small, the premiums are payable weekly or monthly. Occasionally, a single lump sum (termed a "single premium") is paid, and the assurance company, in such cases, issues a fully-paid policy. The premiums payable under "annuity policies" are technically termed the "consideration for annuities granted," and in most cases these consist of single payments, the company paying the annuity, i.e., an annual sum to the person assured (the annuitant), from a specified date.

Premiums for other classes of insurance, e.g., fire, burglary, etc., are usually payable yearly.

Surrender Value.

This term is used to denote the monetary value of life assurance policies which will be paid to the assured in the event of the latter wishing to "surrender" his policy and to cancel the contract of assurance. Usually, a policy has to be in force a stated minimum period (say three years) before it acquires a surrender value, and thereafter the value increases proportionately with the payment of each successive year's premium.

Statutory Provisions relating to Accounts of Insurance Companies.

The accounts of insurance companies are regulated by the provisions of the Assurance Companies Act, 1909, the form of the Revenue Accounts, Profit and Loss Account and Balance Sheet being prescribed by the First, Second and Third Schedules to that Act respectively. Insurance Companies (other than mutual companies) are, however, also subject to the Companies Act, 1929, so far as this Act applies, and the provisions of this Act regarding disclosure in Balance Sheets must, therefore, be observed. Accident companies are also required to render returns under the Fourth Schedule, but companies which transact marine insurance business only are not subject to these statutory requirements.

The ordinary principles of double entry book-keeping apply equally to insurance companies' accounts as to general commercial accounts, and the columnar or tabular system of arranging the subsidiary books is particularly suitable to insurance accounting. The books in use necessarily vary according to the nature of the business transacted, but they will include :—

Policy Registers.
Renewal Premium Registers.
Premium Cash Books.
Agency Cash Books.
Investment and Dividend Registers.
Claims Register.
General Cash Book.

These registers are essentially technical, and, as may be expected, the forms in actual practical use vary considerably.

Deposits with the Paymaster-General.

Every assurance or insurance company transacting any of the following classes of business, viz. :—

(*a*) Life Assurance ;
(*b*) Fire Insurance ;
(*c*) Accident Insurance (commonly called Personal Accident) ;
(*d*) Employers' Liability Insurance ; and
(*e*) Bond Investment,

must deposit, and keep deposited, with the Paymaster-General, for and on behalf of the Supreme Court, the sum of £20,000, subject to the provisos mentioned below, and this sum will be invested in such securities as are usually accepted by the Court and which the Company may select, the interest thereon being paid to the Company.

The following table summarises the principal requirements relating to deposits :—

Class of Insurance.	Deposit Required.
Life.	£20,000. This deposit is not withdrawable so long as a company transacts life assurance business.
Fire.	£20,000. Where a deposit has already been made in respect of another class of business, no further deposit is required for fire business.
Accident.	£20,000. Where a deposit has already been made in respect of another class of business, no further deposit is required for accident business.
Employers' Liability.	£20,000. Where a deposit has already been made in respect of another class of business, and the Employers' Liability Fund amounts to £40,000, no further deposit is required for Employers' Liability business.
Bond Investment.	£20,000. Where a deposit has already been made in respect of another class of business, and the Bond Investment Fund amounts to £40,000, no further deposit is required for Bond Investment business.

The Industrial Assurance Act, 1923, requires a deposit of £20,000 to be maintained for industrial life business.

Separation of Funds.

Under the provisions of Section 3 of the Act (this and other "section" references in this chapter are to the Assurance Companies Act, 1909), a company transacting other business besides that of assurance is required to keep separate accounts for the insurance business transacted. Moreover, if more than one class of insurance business is transacted, whether by a company transacting insurance business only, or otherwise, separate accounts must be kept of each class of assurance or insurance business transacted.

It is accordingly necessary for all monies received in respect of each class of business to be carried to and form a separate assurance fund with an appropriate name, e.g., Life Assurance Fund, Employers' Liability Insurance Fund, etc., and it is the duty of the auditors to certify that this provision has been complied with.

In connection with these special funds, it should be noted that a fund of any particular class is to be considered as belonging absolutely to the policy-holders of that class, in the same way as if the company carried on that particular class of business only. Consequently, it is illegal for any company to use or draw on, e.g., the Life Fund, in respect of Fire claims.

This Section applies, in its entirety, to Life assurance and Employers' Liability insurance, but with respect to Fire and Accident insurance it is modified by the provisions of Sections 31 and 32, which enact that the funds in respect of these two classes of business need not be kept separate but may be merged, if it is so desired.

The Act makes no stipulation as to the investment of the various funds, and these need not be kept separate, but may be pooled. The separate accounts will indicate what proportion of the total investments is applicable to each fund. It should be noted, however, that a large number of companies prefer to earmark their investments in respect of each fund, but whilst this is sometimes accurately done, in other instances the allocation is only approximate. If the funds are not earmarked, the interest on the total investments is ascertained and the net rate earned applied to each separate fund, that is, each fund receives its due proportion.

With life assurance funds, however, many composite companies not only separately earmark their investments but keep the whole of the transactions for this class of business quite distinct and issue a separate balance sheet for the life assurance department.

Accounts in Prescribed Form.

Every assurance company must, at the expiration of each financial year, prepare—

(a) A Revenue Account for each class of business transacted,
(b) A Profit and Loss Account, and
(c) A Balance Sheet,

in the form set out in the First, Second, and Third Schedules to the Act respectively.

Profits of Life Assurance: How Ascertained.

The profits of a life assurance company (or the life department of a composite insurance company) can be ascertained only by means of an actuarial valuation of its assets and liabilities; this valuation must be made once at least in every five years (Section 5). Some companies make this valuation yearly, but, more usually, it is made every fifth year, and thus is known as the *Quinquennial Valuation.* The necessity for this procedure arises from the fact that the profits—or losses—on life assurance business cannot be determined by ordinary commercial methods.

The method adopted is to prepare, by means of actuarial tables, a valuation statement showing—

(1) The present value of the company's total liabilities on its current policies in force; and
(2) The present value of the total premiums receivable by the company under its policies, excluding that portion of the premium required for expenses, etc.

The difference between these two figures is the company's net liability on the policies and is transferred to the left (or debit) side of the Valuation Balance Sheet. On the right-hand side appears the total amount of the Life Assurance funds, and the difference between these two amounts will be the surplus or deficiency as the case may be. The following is the ordinary form of Valuation Balance Sheet:—

VALUATION BALANCE SHEET OF THE ARCTIC ASSURANCE COMPANY.

Dr. AS AT 31ST DECEMBER, 19.. *Cr.*

	£		£
To net liability under Life Assurance and Annuity transactions (as per summary statement provided in Fourth Schedule (A))		By Life Assurance and Annuity funds (as per balance sheet under Schedule 3) . . .	
,, Surplus, if any . .		,, Deficiency, if any . .	
	£		£

The surplus is dealt with according to the constitution of the company. In the case of mutual companies the whole of the surplus (including the surplus from "without profits" policies) is available for division amongst the "with profits" policy-holders. In the case of proprietary companies the "with profits" and "without profits" policies are customarily kept in two distinct classes; a certain proportion of the profits arising from the former class is allocated for division as "bonuses" to the policy-holders of that class, and the remainder is available, together with the entire surplus on the "without profits" policies, for distribution to the shareholders. The usual practice is to transfer one-fifth of the surplus each year to the General Profit and Loss Account.

Ascertainment of Profits on Fire Insurances, etc.

The profits on Fire and other classes of Insurance are ascertained by setting against the income received the amount of claims, losses and expenses, etc., and reserving a percentage, usually 40 per cent., of the net premiums for unexpired risks. This adjustment is made in the Revenue Account.

The Revenue Account of an Insurance Company.

The one outstanding difference between the Revenue Account of an insurance company and that of an ordinary trading company is that in the former the location of items is reversed.

The general rule of book-keeping in connection with trading companies is that in the case of Nominal Accounts, under which heading the Revenue Account is classified, *debit* entries represent *losses and expenses*, whilst *credit* entries represent *profits or gains*. In connection with insurance accounts, however, the *debit* side of the Revenue Account contains the *profits or gains*, and the *credit* side represents *losses and expenses*. This important point of practice should be borne in mind, but it must be remembered that this reversal of sides applies only to the final accounts, and not to the actual ledger accounts themselves.

The abbreviations "Dr." and "Cr." are omitted from the final accounts of insurance companies, and as the Act is responsible for the nature of these forms, they must be accepted and adhered to, although not in conformity with the usual practice in commercial accountancy.

The student who has mastered thoroughly the general principles of book-keeping will realise that the Revenue Account is a concise summary showing on the one side the true income for the period, and on the other side the true charges incurred relating to that income.

In other words, the left-hand (or "debit") side of an

Assurance Company's Revenue Account shows the following, viz. :—

(a) The Property (Insurance Fund) at the commencement of the year, *and*

(b) The premiums and other income for the year of account.

The right-hand (or " credit ") side shows :—

(a) The losses (including claims and surrenders) and expenses rightly chargeable against that income ;

(b) Any surplus or realised profits which have been transferred to Profit and Loss Account, *and*

(c) The Property (Insurance Fund) at the end of the year.

Since the profits of a life assurance company can be ascertained only by actuarial valuation, the balance of the revenue account does not represent profit, as in the case of a trading concern, but simply indicates the proportion of the assets which is available for the purposes of that particular fund.

Section 4 of the Act demands that a separate Revenue Account in respect of each class of business must be prepared and issued. Mainly, the same features appear in each, as is shown in the examples given on pages 730 to 732. In these cases special attention should be paid to the apportionment of general charges, as the percentages of working expenses to premium income vary in different classes of business.

The Profit and Loss Account of an Insurance Company.

In an ordinary trading company, the Profit and Loss Account includes on the *debit* side all losses and expenses, and on the *credit* side all profits and gains, in each case arising out of the period of account only.

Insurance companies are required to reverse these sides, as in the Revenue Accounts, and to utilise the form prescribed by the Act. In such cases, the income not otherwise dealt with, and profits realised from the several Revenue Accounts, are placed on the left-hand side, whilst losses realised as shown by the Revenue Accounts, dividends and bonuses paid to shareholders, and other payments and expenses not chargeable to Revenue Accounts, are included on the right-hand side.

Section 4 of the Act stipulates that a Profit and Loss Account must be prepared, annually, by every insurance company transacting *more than one* class of insurance business. That is to say, a company transacting Fire business only (or any other single class of business) is not required to prepare a Profit and Loss Account in addition to its Revenue Account.

In order that the policy-holders of the company may know the amount of the dividends paid to shareholders, it is usual, in such cases, either to show the dividends paid on the expenditure side of the Revenue Account, under the heading "Other Payments," or to prepare a Profit and Loss Account in the usual manner.

An example of a Profit and Loss Account in the statutory form (Second Schedule) is given on page 732, and it should be noted that the balance of this account represents the undistributed balance of profits. The net profit for the year may be arrived at by adding the dividend to the closing balance and deducting the commencing balance.

From a commercial viewpoint a more correct method of ascertaining the current year's profits would be to show separately the Interest and Dividends, Profits realised, etc., deducting therefrom the Expenses, Losses and Income Tax, but the accounts must be shown in the form provided for in the Act.

The Balance Sheet of an Insurance Company.

The Liabilities are shown on the left-hand side of the Balance Sheet, and the Assets on the right-hand side, and in this respect there is no difference between commercial and insurance Balance Sheets. A specimen Balance Sheet in the prescribed form is given on page 733, from which it will be seen that the liabilities of insurance companies may be classified under three general headings, viz.,

(*a*) Funds, including Paid-up Share Capital,
(*b*) Outstanding Claims,
(*c*) Other sums owing by the Company,

while the assets may be classified under five general headings, viz.,

(*a*) Mortgages (two classes).
(*b*) Loans (six classes).
(*c*) Investments (eighteen classes).
(*d*) Cash and other "liquid" Assets.
(*e*) Sums owing to the Company.

FIRST SCHEDULE

(A.)—*Form applicable to Life Assurance Business.*

REVENUE ACCOUNT OF THE BLANK INSURANCE CO., LTD.

FOR THE YEAR ENDING 31ST DECEMBER, 19.., IN RESPECT OF LIFE ASSURANCE BUSINESS.

		Business within the United Kingdom.	Business out of the United Kingdom.	TOTAL.
		£	£	£
Amount of life assurance fund at the beginning of the year		8,013,000	No Foreign business is transacted.	8,013,000
Premiums		1,040,000		1,040,000
Consideration for annuities granted		75,000		75,000
Interest, dividends and rents	£ 700,000			
Less income tax thereon	278,000	422,000		422,000
Other receipts (accounts to be specified)				nil.
		£9,550,000		£9,550,000

	Business within the United Kingdom.	Business out of the United Kingdom.	TOTAL.
	£	£	£
Claims under policies paid and outstanding:—		No Foreign business is transacted.	
By death	630,000		630,000
By maturity	210,000		210,000
Surrenders, including surrenders of bonus	24,000		24,000
Annuities	29,000		29,000
Bonuses in cash	9,000		9,000
Bonuses in reduction of premiums	2,500		2,500
Commission	28,500		28,500
Expenses of management	75,000		75,000
Other payments (accounts to be specified)			
Amount of life assurance fund at the end of the year, as per Third Schedule	8,542,000		8,542,000
	£9,550,000		£9,550,000

NOTE 1.—Companies having separate accounts for annuities to return the particulars of their annuity business in a separate statement.

NOTE 2.—Companies having both Ordinary and Industrial branches to return the particulars of the business in each department separately.

NOTE 3.—Items in this Account to be net amounts after deduction of the amounts paid and received in respect of reassurances of the Company's risks.

NOTE 4.—If any sum has been deducted from the expenses of management account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.

NOTE 5.—Particulars of the new life assurances effected during the year of account to be appended to the above Account showing separately, as respects business within and business out of the United Kingdom, the number of policies, the total sums assured, the amount received by way of single premiums, and the amount of the yearly renewal premium income, the items to be net amounts after deduction of the amounts paid and received in respect of reassurances of the company's risks. The particulars as to yearly renewal premium income need not be furnished in respect of Industrial business.

NOTE 6.—The columns headed "Business out of the United Kingdom," in the case of companies having their head office in the United Kingdom, apply only to business secured through Branch Offices or Agencies out of the United Kingdom.

FIRST SCHEDULE

(B.)—*Form applicable to Fire Insurance Business.*

REVENUE ACCOUNT OF THE BLANK INSURANCE CO., LTD.

FOR THE YEAR ENDING 31ST DECEMBER, 19.., IN RESPECT OF FIRE INSURANCE BUSINESS.

	£	£		£	£
Amount of fire insurance fund at the beginning of the year:—			Claims under policies paid and outstanding . . .		800,000
Reserve for unexpired risks .	600,000		Commission		200,000
Additional reserve (if any) .	40,000		Expenses of management .		350,000
		640,000	Contributions to fire brigades .		13,000
Premiums . .		1,600,000	Other payments (accounts to be specified).		
Interest, dividends and rents . .	72,000		*Profit realised transferred to Profit and Loss Account* .		261,000
Less income tax thereon . .	28,000		Amount of fire insurance fund at the end of the year as per Third Schedule:—		
		44,000	Reserve for unexpired risks, being 40* per cent. of premium income for the year .	640,000	
Other receipts (accounts to be specified)		*nil*	Additional Reserve (if any) . .	20,000	
					660,000
		£2,284,000			£2,284,000

* This figure is inserted merely for the purpose of illustration; no definite percentage is stated in the Act.

NOTE 1.—Items in this Account to be the net amounts after deduction of the amounts paid and received in respect of reinsurances of the Company's risks.

NOTE 2.—If any sum has been deducted from the Expenses of Management account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above account.

FIRST SCHEDULE

(C.)—*Form applicable to Accident Insurance Business.*

REVENUE ACCOUNT OF THE BLANK INSURANCE CO., LTD.

FOR THE YEAR ENDING 31ST DECEMBER, 19.., IN RESPECT OF ACCIDENT INSURANCE BUSINESS.

	£	£		£	£
Amount of accident insurance fund at the beginning of the year:—			Payments under policies, including medical and legal expenses in connection therewith . .		145,000
Reserve for unexpired risks . . .	71,500		Commission		26,500
Total estimated liability in respect of outstanding claims .	4,500		Expenses of management . .		9,500
Additional reserve (if any) . . .	1,000		Other payments (accounts to be specified)—		
		77,000	Amount of accident insurance fund at the end of the year as per Third Schedule:—		
Premiums		180,000	Reserve for unexpired risks, being 40 per cent. of premium income for the year	72,000	
Interest, dividends, and rents	3,900		Total estimated liability in respect of outstanding claims as per Fourth Schedule (C) .	6,500	
Less income tax thereon . . .	1,900		Additional reserve (if any) . .	1,500	
		2,000			80,000
Other receipts (accounts to be specified)—					
Loss realised transferred to Profit and Loss Account .		2,000			
	£	261,000		£	261,000

NOTE 1.—Items in this Account to be the net amounts after deduction of the amounts paid and received in respect of reinsurances of the Company's risks.

NOTE 2.—If any sum has been deducted from the Expenses of Management account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above account.

SECOND SCHEDULE

PROFIT AND LOSS ACCOUNT OF THE BLANK INSURANCE CO., LTD.

FOR THE YEAR ENDING 31ST DECEMBER, 19..

	£	£		£	£
Balance of last year's account .		320,000	Dividends and bonuses to shareholders . . .		90,000
Interest and dividends not carried to other accounts .	90,000		Expenses not charged to other accounts		25,000
Less income tax thereon .	40,000		Loss realised (accounts to be specified)—		
		50,000	*Accident Account* . .	2,000	
Profit realised (accounts to be specified)—			*Marine Account* . .	6,000	
Fire Account . . .	261,000				8,000
Employers' Liability Account . . .	90,000		Other payments (accounts to be specified)—		
		351,000	*Income Tax paid and provided for*		150,000
Other receipts (accounts to be specified)—			Balance as per Third Schedule .		448,200
Transfer Fees . . .		200			
		£721,200			£721,200

THIRD SCHEDULE

BALANCE SHEET OF THE BLANK INSURANCE COMPANY, LTD.

ON THE 31ST DECEMBER, 19..

Liabilities.	£	£
Shareholders' Capital:—		
Authorised and fully subscribed, 500,000 shares of £5 each, of which £1 per share is paid up	500,000	
Life Assurance Funds *:—		
Ordinary branch	8,542,000	
Industrial do.	*nil*	
Annuity Fund *	300,000	
Fire Insurance Fund	660,000	
Accident Insurance Fund	80,000	
Employers' Liability Insurance Fund	300,000	
Bond Investment and Endowment Certificate Fund	*nil*	
Marine Insurance Fund	200,000	
Sinking Fund and Capital Redemption Fund *	102,800	
Profit and Loss Account	448,200	
Other Funds (if any) to be specified		
General Reserve Fund	209,000	
		11,342,000
Claims Admitted or Intimated but not Paid †:—		
Life assurance	200,000	
Fire insurance	230,000	
Bond investment	*nil*	
		430,000
Annuities due and unpaid †	200	
Other sums owing by the company † (to be stated separately under each class of business).		
Unclaimed Dividends	3,800	
Bills Payable	17,000	
Outstanding Commission and other Charges:—		
Life Account	9,000	
Fire Account	15,000	
Accident Account	1,000	
Employers' Liability Account	2,000	
Profit and Loss Account	180,000	
		228,000
		£12,000,000

Assets.	£
Mortgages on property within the United Kingdom	300,000
Mortgages on property out of the United Kingdom	200,000
Loans on Parochial and other Public Rates	65,000
Do. Life Interests	25,000
Do. Reversions	40,000
Do. Stocks and Shares	10,000
Do. Company's Policies within their Surrender Values	300,000
Do. Personal Security	1,000
Investments:—	
Deposit with the High Court (securities to be specified)	20,000
British Government Securities	4,500,000
Municipal and County Securities, United Kingdom	250,000
Indian and Colonial Government Securities	400,000
Do. Provincial Securities	16,000
Do. Municipal Securities	200,000
Foreign Government Securities	450,000
Do. Provincial Securities	60,000
Do. Municipal Securities	230,000
Railway and other Debentures and Debenture Stocks—Home and Foreign	2,000,000
Railway and other Preference and Guaranteed Stocks	600,000
Railway Ordinary Stocks	250,000
Rent Charges	190,000
Freehold Ground Rents	300,000
Leasehold Do.	100,000
House Property	310,000
Life Interests	6,000
Reversions	25,000
Agents' Balances	420,000
Outstanding Premiums †	380,000
Do. Interest, Dividends, and Rents	5,000
Interest accrued but not payable †	100,000
Bills Receivable	26,000
Cash:—	
On Deposit	16,000
In Hand and on Current Account	205,000
Other Assets (to be specified)	*nil*
	£12,000,000

* Life companies having separate annuity fund to show amount thereof separately.

† These items are or have been included in the corresponding items in the First Schedule.

NOTE 1.—When part of the assets of the company are specifically deposited, under local laws, in various places out of the United Kingdom, as security to holders of policies there issued, each such place and the amount compulsorily lodged therein must be specified in respect of each class of business, except that, in the case of fire, accident, or employers liability insurance business, it shall be sufficient to state the fact that a part of the assets has been so deposited.

NOTE 2.—A Balance Sheet in the above form must be rendered in respect of each separate fund for which separate investments are made.

NOTE 3.—The Balance Sheet must state how the values of the Stock Exchange securities are arrived at, and a certificate must be appended, signed by the same persons as sign the Balance Sheet to the effect that in their belief the assets set forth in the Balance Sheet are in the aggregate fully of the value stated therein, less any investment reserve fund taken into account. In the case of a company transacting life assurance business or bond investment business, this certificate is to be given on the occasions only when a statement respecting valuation under the Fourth Schedule is made.

NOTE 4.—In the case of a company required to keep separate funds under Section 3 of this Act, a certificate must be appended, signed by the same persons as signed the Balance Sheet and by the Auditor, to the effect that no part of any such fund has been applied, directly or indirectly, for any purpose other than the class of business to which it is applicable.

EXAMPLE.

From the following figures of the Thor Insurance Company, Limited, you are required to prepare Revenue Accounts, Profit and Loss Account and Balance Sheet, as at 31st December, 19.. :—

TRIAL BALANCE AS AT 31ST DECEMBER, 19..

	£	£
FIRE INSURANCE.		
Claims paid and outstanding	14,000	
Expenses of Management	11,380	
Commission	2,140	
Premiums		38,160
EMPLOYERS' LIABILITY.		
Claims	15,240	
Expenses of Management	30,190	
Commission	9,000	
Premiums		89,240
GENERAL INSURANCE.		
Claims paid and outstanding	146,280	
Expenses of Management	86,190	
Commission	30,240	
Premiums		360,280
Interest and Dividends (net)		4,700
ACCIDENT INSURANCE.		
Claims paid and outstanding	480	
Expenses of Management	1,240	
Commission	980	
Premiums		5,200
Share Capital (523,150 shares, £1 paid up)		523,150
Claims admitted but not paid		90,140
Cash	156,290	
British Government Securities	500,520	
Indian and Colonial Government Securities	156,290	
Agents' Balances	120,290	
Sundry Debtors	2,100	
Amount due to other Companies and Agents		33,740
Sundry Creditors		24,100
Amount written off Securities	2,240	
Employers' Liability Insurance Fund *at beginning of year*		26,240
General Insurance Fund *at beginning of year*		62,140
Accident Insurance Fund *at beginning of year*		1,000
Fire Insurance Fund *at beginning of year*		10,420
Profit and Loss Account *at beginning of year*		39,280
Interest and Dividends (net)		3,500
Investments deposited with the High Court	26,200	
	£1,311.290	£1,311,290

You are required to make a specific reserve of 40% on the premiums received in respect of unexpired risks.

The authorised share capital consists of 600,000 shares of £3 each.

The investments are valued at market price.

THE THOR INSURANCE COMPANY, LIMITED
REVENUE ACCOUNT.

FOR THE YEAR ENDING 31ST DECEMBER, 19.., IN RESPECT OF FIRE INSURANCE BUSINESS.

	£		£
Amount of Fire Insurance Fund at the beginning of the year :—		Claims paid and outstanding	14,000
		Commission . . .	2,140
		Expenses of Management .	11,380
Reserve for unexpired risks	10,420	Transferred to Profit and Loss Account . . .	5,796
Premiums	38,160	Amount of Fire Insurance Fund at end of the year as per Third Schedule :—	
		Reserve for unexpired risks, being 40% of the premium income for the year .	15,264
	£48,580		£48,580

THE THOR INSURANCE COMPANY, LIMITED
REVENUE ACCOUNT.

FOR THE YEAR ENDING 31ST DECEMBER, 19.., IN RESPECT OF ACCIDENT INSURANCE BUSINESS.

	£		£
Amount of Accident Insurance Fund at beginning of the year :—		Claims	480
		Commission . . .	980
		Expenses of Management .	1,240
Reserve for unexpired risks	1,000	Transferred to Profit and Loss Account . . .	1,420
Premiums	5,200	Amount of Accident Insurance Fund at end of the year as per Third Schedule :—	
		Reserve for unexpired risks, being 40% of Premium Income for the year .	2,080
	£6,200		£6,200

THE THOR INSURANCE COMPANY, LIMITED
REVENUE ACCOUNT.

FOR THE YEAR ENDING 31ST DECEMBER, 19.., IN RESPECT OF EMPLOYERS' LIABILITY INSURANCE BUSINESS TRANSACTED WITHIN THE UNITED KINGDOM.

	£		£
Amount of Employers' Liability Insurance Fund at beginning of the year :—		Claims	15,240
		Commission . . .	9,000
		Expenses of Management .	30,190
Reserve for unexpired risks	26,240	Transferred to Profit and Loss Account . . .	25,354
Premiums	89,240	Amount of Employers' Liability Insurance Fund at end of the year as per Third Schedule :—	
		Reserve for unexpired risks, being 40% of Premium Income for the year .	35,696
	£115,480		£115,480

THE THOR INSURANCE COMPANY, LIMITED
REVENUE ACCOUNT.

For the Year ending 31st December, 19.., in respect of General Insurance Business.

	£		£
Amount of General Insurance Fund at beginning of the year :—		Claims paid and outstanding .	146,280
Reserve for unexpired risks	62,140	Commission . . .	30,240
Premiums	360,280	Expenses of Management .	86,190
Interest and Dividends (net) .	4,700	Transferred to Profit and Loss Account . . .	20,298
		Amount of General Insurance Fund at end of the year as per Third Schedule :—	
		Reserve for unexpired risks, being 40% on Premium income for the year .	144,112
	£427,120		£427,120

THE THOR INSURANCE COMPANY, LIMITED
PROFIT AND LOSS ACCOUNT.

For the Year ending 31st December, 19...

	£	£		£
Balance of last year's Account . .		39,280	Amount written off Securities	2,240
Interest and Dividends (net) not carried to other Accounts .		3,500	Balance as per Third Schedule	93,408
Profit realised :—				
Fire Insurance . .	5,796			
Accident Insurance .	1,420			
Employers' Liability Insurance . .	25,354			
General Insurance .	20,298			
		52,868		
		£95,648		£95,648

THE THOR INSURANCE COMPANY, LIMITED
BALANCE SHEET.

As at 31st December, 19...

Liabilities.	£	*Assets.*	£
Share Capital :—		Investments at market price :—	
Authorised—		Deposited with the High Court	26,200
600,000 shares of £3 each	1,800,000	British Government Securities	500,520
Issued—		Indian and Colonial Government Securities . .	156,290
523,150 shares, £1 paid up	523,150	Agents' Balances . .	120,290
Fire Insurance Fund . .	15,264	Sundry Debtors . . .	2,100
Accident Insurance Fund .	2,080	Cash	156,290
Employers' Liability Insurance Fund . . .	35,696		
General Insurance Fund .	144,112		
Profit and Loss Account .	93,408		
Claims admitted but not paid	90,140		
Sundry Creditors . . .	24,100		
Amount due to other Companies and Agents . . .	33,740		
	£961,690		£961,690

MARINE INSURANCE

Where a composite insurance company undertakes marine insurance business the provisions of the Assurance Companies Act, 1909, apply, and a separate revenue account for that department must be compiled in similar form to the Fire Insurance Revenue Account illustrated on page 731.

On the other hand, those companies which transact only marine insurance business are free to adopt their own form of accounts. The general practice is to compile a separate Underwriting Account for each year's operations, and to place to the credit of this account the net premiums for the year, claims paid, office expenses, etc., being set off against the premium income. As some of the premiums received during the year will not expire until towards the end of the next year and claims may not be notified for some months after they occurred, it is usual to keep the Underwriting Accounts open for three years. Even at the end of the third year it is usual to make some reserve for claims unsettled or in dispute and the balance of the account, representing profit or loss on the underwriting transactions of the year ended two years ago, is transferred to Profit and Loss Account. Thus at any given moment there are three underwriting accounts open ; each of these is only closed at the expiration of two years from the end of the year to which it nominally refers (the 1939 underwriting account is closed on 31st December, 1941, and so on).

BUILDING SOCIETIES' ACCOUNTS.

Building Societies may be defined as "associations of persons formed for the purpose of raising a fund to be employed in making advances to such of their members as desire to borrow on the security of freehold or leasehold property." The modern form of building society, i.e., the incorporated society, is not a joint stock company but a special association governed by the provisions of the Building Societies Acts, 1874 to 1894, and controlled by the Registrar of Friendly Societies.

The members of a Building Society may be divided into two classes, investors and borrowers, the former supplying the funds from which the latter borrow. The difference between the rates of interest received from borrowers, and the rates paid to investors, forms the margin from which the Building Society meets establishment expenses, and accumulates the large reserves so essential to the success of an undertaking of this nature.

The various methods of keeping the internal records of a Building Society are beyond the scope of this work and it is proposed merely to describe here the form and contents of the published accounts. It may, however, be stated in passing that the ordinary principles of double-entry book-keeping apply equally to Building Societies' accounts as to those of general commercial undertakings.

Statutory Provisions Relating to Accounts of Building Societies.

The published accounts of a Building Society must be presented in the form prescribed by the Chief Registrar of Friendly Societies, the form adopted in practice invariably being that set out in the Schedule to the Building Societies Act, 1894, as amended by subsequent legislation. The current form of annual accounts is made up of eight accounts, which are summarised in the following paragraphs :—

1. SHARES ACCOUNT. This account is, in effect, a summary of the year's transactions in all the accounts in the share ledger (or ledgers). It is in the following form :—

1. SHARES ACCOUNT.

Dr. *Cr.*

	£		£
Withdrawals and Interest . .		Subscriptions	
		Interest . . .	
Other Debits (to be specified) :—		Other Credits (to be specified):—	
Due to Shareholders at end of year		Due to Shareholders at beginning of year . . .	
£		£	

2. DEPOSITS AND LOANS ACCOUNT, and 3. MORTGAGES ACCOUNT. These two accounts are also summary accounts, drawn up on similar lines to the Shares Account. Account 2 shows all loans, etc., made *to* the society whilst Account 3 shows all loans, etc., made *by* the society.

2. DEPOSITS AND LOANS ACCOUNT.

Dr. *Cr.*

	£		£
Deposits and Loans (other than Loans from Bank) and Interest repaid or withdrawn . .		Deposits and Loans (other than Loans from Bank) . .	
		Interest thereon	
Loans from Bank and Interest repaid (or reduction in Overdrafts)		Loans from Bank (or increase in Overdrafts) . . .	
		Interest thereon . . .	
Other Debits (to be specified) :—		Other credits (to be specified):—	
Due on Deposits and Loans (other than Loans from Bank) at end of year . . .		Due on Deposits and Loans (other than Loans from Bank) at beginning of year .	
Due to Bank for Loans and Overdrafts at end of year .		Due to Bank for Loans and Overdrafts at beginning of year	
£		£	

3. MORTGAGES ACCOUNT.

Dr.	£	*Cr.*	£
Advanced on Mortgage :—		Repayments of Advances and Interest	
On ...... Mortgages where the advance agreed to will not exceed £1,000 . .		Losses on Realisation :—	
On . . . Mortgages where the advance agreed to will exceed £1,000 . . .		Charged to A/c No. 5 . .	
Interest from Borrowers . .		Charged to A/c No. . . .	
Insurance Premiums . .		Insurance Premiums . .	
Survey Fees and Expenses .		Survey Fees and Expenses .	
Other Debits (to be specified) :—		Other Credits (to be specified):—	
Due on Mortgages at beginning of year		Due on Mortgages at end of year	
£		£	

4. Investments Account. This account is a combined summary of the society's various investment accounts and interest and dividends on investment accounts. It is in the following form :—

4. INVESTMENTS ACCOUNT.

Dr.	£	*Cr.*	£
Investments made :—		Investments realised :—	
British Government Securities		British Government Securities	
Colonial and Dominion Securities		Colonial and Dominion Securities . . .	
British Municipal and County Securities		British Municipal and County Securities . . .	
Other Investments (to be specified) :—		Other Investments (to be specified) :—	
Profits on Realisation of Investments, as per A/c No. . . .		Losses on Realisation of Investments, as per A/c No.	
Interest and Dividends as per A/c No. 5		Depreciation of Investments, as per A/c No.	
		Interest and Dividends received	
Total . .		Total . .	
Balance at beginning of year (including interest accrued) .		Balance at end of year (including interest accrued) . . .	
£		£	

5. Profit and Loss Account. In this account the management expenses and interest, etc., paid are set off against the interest received and other sundry receipts thereby showing the net gain or loss of the society on the period's transactions. This account is set out below :—

Dr. 5. PROFIT AND LOSS ACCOUNT. *Cr.*

	£		£
Expenditure.		*Income.*	
Management Expenses :—		Interest from Borrowers . .	
Remuneration of Directors, Staff and Auditors . .		Interest and Dividends from Investments . . .	
Rent, Rates, Insurance, Heat, Light, Cleaning, Repairs (Offices)		Profits on Realisation of Investments	
Printing, Stationery and Postages		Bank Interest . . .	
Advertising, Commission and Agency Fees . . .		Rents from Letting of Office Premises	
Other Expenses (to be specified) :—		Survey Fees and Expenses .	
Total Management Expenses .		Other Fees, Fines, Rules and Pass Books . . .	
Survey Fees and Expenses .		Commission (Fire, Life, etc., Insurance)	
Interest on Deposits and Loans .		Other Income (to be specified) :—	
Income Tax			
Losses on Mortgages as per A/c No. 3			
Losses on Realisation of Investments			
Depreciation :—			
Investments			
Office Premises, Furniture, etc.			
Other Assets . . .			
Other Expenditure (to be specified) :—			
Balance carried down to A/c No. 6			
£		£	

6. Appropriation Account. This account is analogous to the Profit and Loss (Appropriation) Account of a limited company, and is drawn up as follows :—

Dr. 6. APPROPRIATION ACCOUNT. *Cr.*

	£		£
Interest, Dividend and Bonus to Shareholders . . .		Balance brought forward .	
Other Appropriations (to be specified)		Balance brought down from A/c No. 5	
Balance carried forward . .			
£		£	

7. General Reserve Fund Account.—This account shows the opening and closing reserves, appropriations from Account No. 6 and any other transfers to or from reserve.

Dr. 7. GENERAL RESERVE FUND ACCOUNT. *Cr.*

	£		£
Debits (to be specified) :—		Appropriations from A/c No. 6 Other Credits (to be specified) :—	
Total . .		Total . .	
Balance at end of year . .		Balance at beginning of year .	
£		£	

Three further skeleton accounts, 7(*a*), 7(*b*), 7(*c*), are also provided, under the general heading "Other Reserve Accounts," for any further reserves that the society may create.

8. Balance Sheet. Allowing for differences in detail, this statement is on much the same general lines as the Balance Sheet of a commercial concern. The reader should have no difficulty in following the ruling given in the illustration on page 742 from which it will be noted that the main headings are as follows:—

Liabilities.

Due to Holders of various classes of Shares, including Interest (the different classes must be shown separately, and the total must agree with the closing balance on Account No. 1).

Due to Creditors for Deposits and Loans, distinguishing between (*a*) Deposits and Loans (other than loans from bank), classified according to notice of withdrawal required, and (*b*) Loans and Overdrafts from Bank (the total must agree with the closing balance on Account No. 2).

Other Liabilities and Contingency Accounts (to be specified).

Reserves (details required of the various reserves).

Balance carried forward as per Account No. 6.

Assets.

Balance due or outstanding on Mortgages, not including prospective interest (the total of this asset must agree with the closing balance on Account No. 3 and considerable detail must be given as will be apparent from a study of the illustration on page 742).

Investments (the sub-division of this item follows the subdivision in Account No. 4 and the total of this asset must agree with the closing balance on Account No. 4, while the market value at the date of the Balance Sheet must be shown inset and any accrued interest must also be stated).

Other Assets (to be specified).

Separate schedules must also accompany the above accounts, showing certain prescribed particulars relating to mortgages held by the Society, that must be excluded in computing the statutory borrowing limits of the Society. In this connection, it should be noted that by the provisions of the Building Societies Act, 1874, such bodies are prevented from borrowing more than two-thirds of the amount for the time being secured to the Society by "active" mortgages. The term "active" mortgages is used to denote all mortgages other than those required to be shown in the second and third of the aforementioned schedules. The contents of these schedules, three in number, are indicated by their headings :—

8. BALANCE SHEET.

Liabilities.	£	£
Due to holders of various classes of Shares, including Interest, viz. :—		
Total, as per A/c No. 1		
Due to Creditors for Deposits and Loans :—		
Deposits and Loans (other than Loans from Bank) (to be classified according to notice required) :—		
Total, as per A/c No. 2		
Loans and Overdrafts from Bank		
As per A/c No. 2		
Other Liabilities and Contingency Accounts (to be specified) :—		
Income Tax		
Interest and/or Bonus		
Total		
Reserves :—		
Total		
Balance carried forward . . . . . . As per A/c No. 6		
		£

Assets.	Market Value at date of Balance Sheet.	£	£
Balance due or outstanding on Mortgages, not including prospective interest, viz. :—			
Mortgages from Members where the repayments are not upwards of 12 months in arrears and the property has not been upwards of 12 months in possession of the Society :—			
On . . . . . . Mortgages where the debt does not exceed £500			
On . Mortgages where the debt exceeds £500 and does not exceed £1,000			
On ... . Mortgages where the debt exceeds £1,000 and does not exceed £3,000			
On ... Mortgages where the debt exceeds £3,000 and does not exceed £5,000			
On . Mortgages where the debt exceeds £5,000, as shewn by Part I. of the Schedule			
Total of Mortgages available under s. 14 of the Act of 1894			
(If the Society has any Mortgages from non-members, the like particulars as above are to be given in full for all such Mortgages.)			
Balance as shown in Parts II. and III. of Schedule, viz. :—			
On Mortgages on Property of which the Society has been upwards of 12 months in possession, as shown by Part II. of the Schedule (Present amount included in assets)			
On. Mortgages where the repayments are upwards of 12 months in arrear, and the property has not been upwards of 12 months in possession of the Society, as shewn by Part III. of the Schedule (Present debt) . . .			
Total number of Mortgages — Total, as per A/c No. 3			
Investments :—			
British Government Securities			
Colonial and Dominion Securities . . .			
British Municipal and County Securities . .			
Other Investments (to be specified) :—			
Interest Accrued			
Total, as per A/c No. 4			
Other Assets (to be specified) :—			
Office Premises			
Cash at Bank and in Hand			
			£

(1) Mortgages where the repayments are not upwards of twelve months in arrear, and the property has not been upwards of twelve months in possession of the Society, and where the present debt exceeds £5,000;

(2) Property of which the Society has been upwards of twelve months in possession; and

(3) Mortgages where the repayments are upwards of twelve months in arrear, and the property has not been upwards of twelve months in possession of the Society.

EXAMPLE.

The following is the Trial Balance of the Lendalot Building Society as at 31st December, 1940:—

TRIAL BALANCE.

	Dr. £	s.	d.	Cr. £	s.	d.
Remuneration of Directors, Staff and Auditors	5,905	8	5			
Rates, Insurance, Heat, Light, Cleaning, Repairs, etc.	2,592	7	3			
Printing, Stationery and Postages	874	16	8			
Advertising: Commission and Agency Fees	1,935	2	1			
Interest on Deposits	8,766	10	7			
Income Tax	11,038	14	3			
Interest from Borrowers				95,630	4	6
Interest from Investments (net)				17,211	4	2
Bank Interest				292	13	6
Rents				1,758	19	6
Survey Fees				643	12	3
Fines				112	17	9
Agency Commission				849	14	0
Interest to Shareholders	68,910	2	7			
Subscription Shares				514,979	11	8
Paid-up Shares				1,654,791	1	5
Deposits at one month's notice				384,832	8	11
General Reserve				125,000	0	0
Special Reserve				10,373	8	10
Balance due on Mortgages:—						
3,778 not exceeding £500	1,075,962	5	8			
660 exceeding £500 but not exceeding £1,000	482,374	10	2			
138 exceeding £1,000 but not exceeding £3,000	235,759	13	5			
18 exceeding £3,000 but not exceeding £5,000	59,817	10	4			
9 exceeding £5,000	187,308	17	2			
2 where repayments are upwards of 12 months in arrear and property has not been upwards of 12 months in possession of Society (Present debt)	927	13	8			
British Government Securities	154,893	12	4			
Loans to Municipal Authorities	347,269	10	4			
Interest accrued on Investments	623	14	7			
Office Premises, Furniture, etc.	97,120	0	0			
Bank Account	64,395	7	0			
	£2,806,475	16	6	£2,806,475	16	6

From the above Trial Balance, in conjunction with the further information set out below, you are required to prepare the statutory accounts of the Building Society for the year 1940.

(a) Included in the balance of British Government securities there is a loss on sale of Investments amounting to £372 18s. 3d.
(b) Reserve for Repairs due as at 31st December, 1940, £120.
(c) Stock of Stationery amounts to £50.
(d) Depreciate Office Premises, Furniture, etc., at 3% on written-down value.
(e) Reserve £1,500 for National Defence Contribution.
(f) Transactions during 1940:—

	£	s.	d.
(i) Share Subscription	236,179	1	3
(ii) Share Withdrawals	208,342	10	7
(iii) Deposits Received	3,942	7	3
(iv) Deposits Repaid	2,748	1	1
(v) Advances—811 not exceeding £1,000	398,274	0	0
92 exceeding £1,000	110,301	10	0
(vi) Insurance Premiums debited to Mortgage Accounts	1,975	8	9
(vii) Insurance Premiums paid by Borrowers	1,962	7	6
(viii) Mortgage Repayments	231,422	10	8
(ix) Investments Sold—British Government Securities	15,273	11	6
(x) Investment Interest Received (net)	12,908	8	2

(g) Transfer balance of Appropriation Account to General Reserve

LENDALOT BUILDING SOCIETY

Annual Accounts for Year ended 31st December, 1940.

1. SHARES ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
Withdrawals and Interest	208,342	10	7	Subscriptions	236,179	1	3
Due to Shareholders at end of year	2,169,770	13	1	Interest	68,910	2	7
				Due to Shareholders at beginning of year	2,073,023	19	10
	£2,378,113	3	8		£2,378,113	3	8

2. DEPOSITS AND LOANS ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
Deposits and Loans (other than Loans from Bank) and Interest repaid or withdrawn	2,748	1	1	Deposits and Loans (other than Loans from Bank)	3,942	7	3
Due on Deposits and Loans (other than Loans from Bank) at end of year	384,832	8	11	Interest thereon	8,766	10	7
				Due on Deposits and Loans (other than Loans from Bank) at beginning of year	374,871	12	2
	£387,580	10	0		£387,580	10	0

3. MORTGAGES ACCOUNT.

Dr.	£ s. d.	Cr.	£ s. d.
Advanced on Mortgages		Repayments of Advances and Interest	231,422 10 8
On 811 Mortgages where the Advance agreed to will not exceed £1,000	398,274 0 0	Insurance Premiums	1,962 7 6
On 92 Mortgages where the Advance agreed to will exceed £1,000	110,301 10 0	Due on Mortgages at end of year	2,042,150 10 5
Interest from Borrowers	95,630 4 6		
Insurance Premiums	1,975 8 9		
Due on Mortgages at beginning of year	1,669,354 5 4		
	£2,275,535 8 7		£2,275,535 8 7

4. INVESTMENTS ACCOUNT.

Dr.	£ s. d.	Cr.	£ s. d.
Interest and Dividends as per Account No. 5	17,211 4 2	Investments Realised :— British Government Securities	15,273 11 6
		Losses on Realisation of Investments as per Account No. 5	372 18 3
		Interest and Dividends Received	12,908 8 2
	17,211 4 2		28,554 17 11
Balance at beginning of year (including interest accrued)	513,757 12 9	Balance at end of year (including interest accrued)	502,413 19 0
	£530,968 16 11		£530,968 16 11

5. PROFIT AND LOSS ACCOUNT.

Dr. *Expenditure.*	£ s. d.	Cr. *Income.*	£ s. d.
Management Expenses :—		Interest from Borrowers	95,630 4 6
Remuneration of Directors, Staff and Auditors	5,905 8 5	Interest and Dividends from Investments	17,211 4 2
Rates, Insurance, Heat, Light, Cleaning, Repairs, etc. (Offices)	2,712 7 3	Bank Interest	292 13 6
Printing, Stationery and Postages	824 16 8	Rents from Letting of Office Premises	1,758 19 6
Advertising, Commission and Agency Fees	1,935 2 1	Survey Fees and Expenses	643 12 3
Total Management Expenses	11,377 14 5	Other Fees, Fines, Rules and Pass Books	112 17 9
Interest on Deposits and Loans	8,766 10 7	Commission (Fire, Life, etc., Insurances)	849 14 0
Income Tax	11,038 14 3		
Loss on Realisation of Investments	372 18 3		
Depreciation :— Office Premises, Furniture, etc.	2,913 12 0		
Other Expenditure :— Reserve for Liability in respect of N.D.C.	1,500 0 0		
Balance carried down to Account No. 6	80,529 16 2		
	£116,499 5 8		£116,499 5 8

6. APPROPRIATION ACCOUNT.

Dr.	£	s.	d.	*Cr.*	£	s.	d.
Interest, Dividend and Bonus to Shareholders . . .	68,910	2	7	Balance brought forward .	—		
Other Appropriations :— General Reserve . . .	11,619	13	7	Balance brought down from Account No. 5 . . .	80,529	16	2
	£80,529	16	2		£80,529	16	2

7. GENERAL RESERVE FUND ACCOUNT.

Dr.	£	s.	d.	*Cr.*	£	s.	d.
Balance at end of year .	136,619	13	7	Appropriation from Account No. 5	11,619	13	7
				Balance at beginning of year .	125,000	0	0
	£136,619	13	7		£136,619	13	7

OTHER RESERVE ACCOUNTS.

7. (*a*) SPECIAL RESERVE ACCOUNT.

Dr.	£	s.	d.	*Cr.*	£	s.	d.
Balance at end of year . .	10,373	8	10	Balance at beginning of year .	10,373	8	10

8. BALANCE SHEET.

Liabilities.

	£ s. d.	£ s. d.
Due to Shareholders of various classes of Shares, including Interest, viz. :—		
Subscription Shares	514,979 11 8	
Paid-up Shares	1,654,791 1 5	
Total as per Account No. 1		2,169,770 13 1
Due to Creditors for Deposits and Loans, viz. :—		
Deposits and Loans (other than Loans from Bank) :—		
Deposits at one month's notice	384,832 8 11	
Total as per Account No. 2		384,832 8 11
Other Liability and Contingency Accounts :—		
Sundry Expense Creditors	120 0 0	
Reserve for N.D.C.	1,500 0 0	
Total		1,620 0 0
Reserves :—		
General Reserve	136,619 13 7	
Special Reserve	10,373 8 10	
Total		146,993 2 5
		£2,703,216 4 5

Assets.

	£ s. d.	£ s. d.
Balance due or outstanding on Mortgages not including prospective interest, viz. :—		
Mortgages from Members where the repayments are not upwards of 12 months in arrear and the property has not been upwards of 12 months in possession of the Society :—		
On 3,778 Mortgages where the debt does not exceed £500		1,075,962 5 8
On 660 Mortgages where the debt exceeds £500 and does not exceed £1,000		482,374 10 2
On 138 Mortgages where the debt exceeds £1,000 and does not exceed £3,000		235,759 13 5
On 18 Mortgages where the debt exceeds £3,000 and does not exceed £5,000		59,817 10 4
On 9 Mortgages where the debt exceeds £5,000		187,308 17 2
Total Mortgages available under Sect. 14 *of the Act of* 1894		2,041,222 16 9
On 2 Mortgages where the repayments are upwards of 12 months in arrear and the property has not been upwards of 12 months in possession of the Society (Present debt)		927 13 8
Total Number of Mortgages=4,605		
Total as per Account No. 3		2,042,150 10 5
Investments :—		
British Government Securities	154,520 14 1	
Other Securities :—		
Loans to Municipal Authorities	347,269 10 4	
Interest accrued	623 14 7	
Total as per Account No. 5		502,413 19 0
Office Premises, Furniture, etc.		94,206 8 0
Cash at Bank and in Hand		64,395 7 0
Stationery Stock		50 0 0
		£2,703,216 4 5

EXERCISE 18.

A. From the following Trial Balance construct the annual accounts in statutory form of the Mackintosh Insurance Company, Limited. Make the customary provision for unexpired risks, say 40% of the premium income.

THE MACKINTOSH INSURANCE COMPANY, LIMITED. *31st December*, 19...

	£	s.	d.	£	s.	d.
Share Capital				316,910	5	0
British Government Securities at cost	340,915	5	0			
Indian and Colonial Govt. Securities at cost	108,425	0	0			
Investments deposited with the High Court	20,050	10	0			
Agents' Balances	75,470	13	4			
Interest accrued but not payable	5,530	7	0			
Sundry Debtors	1,490	19	10			
Amount due to other Companies and Agents				21,670	18	4
Sundry Creditors				17,150	3	8
Reserve for Income Tax and National Defence Contribution				25,020	9	7
Claims admitted but not paid				65,710	18	8
Cash	103,920	6	3			
Amount written off Securities	1,500	0	0			
Interest and Dividends				11,160	12	7
Income Tax and National Defence Contribution	12,270	12	0			
Fire Insurance Fund				7,480	4	0
Accident Insurance Fund				—	—	—
Employers' Liability Insurance Fund				19,930	7	4
General Insurance Fund				45,200	16	0
Profit and Loss Account				28,610	14	2
Premiums— Fire Insurance				25,950	3	9
Claims paid and outstanding Do.	9,750	0	0			
Commission Do.	1,680	13	9			
Expenses of Management Do.	7,240	5	4			
Premiums— Accident Insurance				1,950	17	2
Claims Do.	90	10	0			
Commission Do.	360	10	11			
Expenses of Management Do.	480	15	5			
Premiums— General Insurance				249,170	8	6
Interest and Dividends Do.				2,620	10	0
Claims paid and outstanding Do.	99,300	7	6			
Commission Do.	23,150	3	11			
Expenses of Management Do.	64,710	1	1			
Premiums— Employers' Liability				68,350	13	1
Claims Do.	11,510	2	10			
Interest and Dividends Do.				6,990	8	9
Commission Do.	5,300	13	5			
Expenses of Management Do.	20,730	13	0			
	£913,878	10	7	£913,878	10	7

The authorised share capital consists of 320,000 shares of £2 each. All these shares have been issued and £1 per share called up. Certain calls are in arrear. The securities have been valued at market price.

B. Explain the following terms, as used in connection with Assurance Companies Accounts :—

Assurance, Insurance, Mutual, Proprietary, Quinquennial Valuation, Bonus, Premium.

C. Is the ordinary form of Profit and Loss Account suitable for employment by a Life Assurance Company ? If not, explain how the profits of such undertakings are ascertained.

D. State briefly the provisions relating to deposits to be made by insurance companies with the Paymaster-General.

E. The figures set out below are extracted from the books of the Life Assurance Society, Ltd., and relate to the twelve months ended 31st December, 19... Draft Trial Balance, Revenue Account and Balance Sheet :—

	£
Share Capital (Authorised and Issued) :—	
200,000 5% Preference Shares of £4 each, fully paid	800,000
400,000 Ordinary Shares of £3 each, 10s. paid	200,000
Premiums	679,540
Mortgages on Property	316,051
Amount of Life Assurance Fund at 1st Jan., 19..	4,319,097
Claims under Policies paid and outstanding	336,916
Consideration for Annuities granted	28,426
Surrenders, including surrenders of Bonus	12,705
Loans on Life Interests	189,731
Do. and Investments on Reversions	104,308
Annuities	14,477
Bonuses in reduction of premiums	1,243
Claims due from Reinsuring Companies	388,000
Commission	20,106
Outstanding Premiums	21,864
Agents' Bad Debts	31
Premiums prepaid	28
Management Expenses	31,089
Surplus on Revaluation of Reversions purchased	7,980
Investments	3,768,369
Cash on Deposit and Current Account	830,181

The securities have been valued at cost.

F. Briefly explain the method of ascertaining the profits of an Assurance Company, and illustrate your answer with a *pro forma* example.

G. What are the eight accounts of the Annual Account and Statement prescribed by Statute for Building Societies ? From what source is each account compiled and under what headings are "management expenses" classified in the official form ?

H. State where you would expect to find the following items in the published accounts of a Building Society :—

(*a*) Investments bought and sold during year.
(*b*) Interest due to Shareholders in respect of year.
(*c*) Balance due on Mortgages at beginning and end of year.
(*d*) Increase in General Reserve during year.
(*e*) Survey Fees paid by Society and chargeable to borrowers.

I. From the following Trial Balance, in conjunction with the notes thereto, prepare the Statutory Accounts of the Elgin Building Society for the year ended 31st December, 1940.

TRIAL BALANCE.

31st December, 1940.

	Dr. £	*Cr.* £
Remuneration of Directors, Staff and Auditors	4,000	
Rents, Rates, Insurance, Heat, Light, Cleaning, Repairs, etc	1,000	
Printing, Stationery and Postages	400	
Advertising, Commission and Agency Fees	450	
Bank Charges	70	
Fidelity Premiums	100	
Staff Provident Contributions	200	
Survey Fees and Expenses	500	
Income Tax	6,000	
Deposit Interest	6,000	
Donations	20	
Interest from Borrowers		50,000
Investment Interest		4,000
Bank Interest		500
Rents		100
Survey Fees and Expenses		550
Fees, Fines, Rules and Pass Books		800
Agency Commission		400
Share Interest	35,000	
Subscription Shares		1,121,000
Deposits at one month's notice		70,000
Collector of Taxes Account		2,000
Sundry Expense Creditors		1,000
Insurance Company's Account		500
General Reserve (as at 1st Jan., 1940)		83,000
Mortgage Contingency Reserve (as at 1st Jan., 1940)		6,000
Appropriation Account (as at 1st Jan., 1940)		3,000
Mortgages	1,130,000	
British Government Securities	63,000	
British Municipal and County Securities	58,000	
Office Premises	9,000	
Furniture and Fixtures	600	
Cash at Bank	28,510	
	£1,342,850	£1,342,850

Depreciate Office Premises at 2% of written-down value and Furniture and Fixtures at 10% of written-down value. One-tenth of the available balance is to be placed to the credit of Mortgage Contingency Reserve and the remainder to General Reserve.

CHAPTER XIX

THE INTERPRETATION AND CRITICISM OF PUBLISHED ACCOUNTS; THE ORGANISATION OF ACCOUNTS AND INTERNAL CHECKS

Interpretation of Published Accounts.

Among the many important duties of professional business men, e.g., accountants, secretaries, bankers, etc., is the examination of published accounts with a view to the formation of a sound opinion as to the financial position of the concern under review. Ability to sum up a published Balance Sheet accurately is a quality that can only be acquired by intensive experience, and the reader is strongly advised to endeavour to acquire and develop this quality, as it is a most valuable asset to those who come into contact with commercial or financial matters.

The accounts of limited companies are discussed in this chapter, but similar principles apply to the accounts of other concerns with suitable modification owing to differences in proprietorship.

A published Balance Sheet is, or should be, an exposition of a company's affairs drawn up from the point of view of the company, but devised for the information of shareholders. The Balance Sheet should show the actual state of the company as a going concern, and provided that adequate reserves are made, the Balance Sheet will show, as nearly as possible, the position of the company at a given date.

Balance Sheets and Share Values.

A useful test to apply while engaged upon the examination of the Balance Sheet of a company the shares of which are officially quoted on the Stock Exchange is to work out the value of the company's shares on the basis of Balance Sheet values and to compare that value with the market price of the shares on the date of the Balance Sheet. It will invariably be found that the two figures differ considerably, indicating either that—

(1) The market price is not fixed on the merits or "earning power" of the company but is influenced by "market operations," i.e., buying and selling orders on the Stock Exchange; *or*

(2) One is not justified in assuming that the published Balance Sheet figures are correct beyond all question, *e.g.*, assets may be under- or over-valued.

Both factors may be at work, resulting in an exaggerated effect where they are both exerting an influence in the same direction, and a minimised effect where they work in opposite directions. In both cases the ultimate result is to confirm the lack of agreement between published accounts and market prices, the former thus failing to afford shareholders a reliable indication as to the value of their share-holdings.

Disclosure in Published Accounts.

Prior to the passing of the Companies Act, 1929, a common fault of the modern form of published Balance Sheet was over-reticence. There are various reasons for a certain degree of caution in the publication of the position of a business, but, particularly in the case of a public limited company, Balance Sheets should be sufficiently explicit to allow the proprietors to estimate the commitments of their business, the value of its assets, and, generally, its strength or weakness. The system of grouping several unassociated items under one head is simply a practice of non-disclosure and the result is most unsatisfactory from the shareholders' point of view.

Instances have been noted of the grouping of assets, even by the most reputable and successful companies, where only one total is shown for a miscellaneous and unrelated collection of assets. For example, in the case of the published Balance Sheet issued by one leading company, the following item appeared—"Land, water rights, reservoirs, effluent works, buildings, plant, machinery, motor wagons, horses, office furniture, goodwill, etc., £——." In such a case it was extremely difficult, if not impossible, to form any adequate idea of the value of each of the individual types of assets. This practice of non-disclosure was not always founded upon any intention to deceive but merely upon the view that secrecy is an important factor in successful competition.

The provisions of the Companies Act, 1929, regarding disclosure in published accounts have tended towards a reclassification of assets thus resulting in a greater degree of disclosure; this is evident from an inspection of recently published accounts.

Window-Dressing.

This term refers to the practice of directors of manipulating the accounts so that a favourable position may be shown. Such a practice may be quite justifiable in certain cases, but this depends on the method adopted. No objection could be raised, for example, where an effort had been made to realise as many

book debts as possible just prior to the end of the financial year so that a favourable cash position might be shown (unless, of course, excessively generous discounts have been allowed as an inducement to debtors to pay more quickly than usual). On the other hand an example of improper window-dressing arises when directors discharge, immediately prior to the date of the Balance Sheet, loans obtained from the company and renew the loans immediately afterwards, thus avoiding disclosure in the accounts. The Companies Act, 1929, has put an end to this latter practice, as Section 128 provides that not only loans to directors but also any amounts repaid during the period to which the accounts relate must be separately disclosed. It is, however, still possible to practice a similar subterfuge in respect of loans existing between a holding company and its subsidiary companies; thus, inter-company indebtedness may be cancelled by means of accommodation bills drawn shortly before the date of the Balance Sheet, only to be reinstated by retiring the bills soon after that date.

Persons Interested in Balance Sheets.

In considering the interpretation of published accounts it is essential that one should realise the differences in the viewpoints of the various parties interested. For example, when forming an opinion as to the financial strength of a concern from the information provided by its published accounts one must consider the point of view of the party for whom the investigation is being undertaken. The principal parties interested in Balance Sheets and the information required by them may be summarised as follows:—

(1) CREDITORS. The creditors' point of view is based entirely upon the liquidation of their claims against the company; thus the amount of any prior charges and secured liabilities must be clearly indicated, together with the value of the floating assets. In other words, this class of interested party desires to know whether there will be an adequate surplus of liquid assets to satisfy its claims against the company. These remarks apply also to prospective creditors.

(2) BANKERS. The point of view of bankers is to a certain extent identical with that of creditors, i.e., they are concerned with the realisable value of assets and the sufficiency of assets (after payment of prior charges) to cover the advances made or contemplated.

(3) DEBENTURE-HOLDERS. The point of view of debenture-holders differs from that of bankers inasmuch as although they are concerned in realisable values

they are also interested in "going-concern" values. In the case of long-dated debentures it is essential to ascertain that the payment of interest will almost certainly be effected regularly throughout the term of the debentures. The interest of debenture-holders will also depend on the nature of their charge, i.e., whether it is fixed or floating (see page 282).

(4) PREFERENCE SHAREHOLDERS. This class of shareholder is concerned with the maintenance of profits with a view to ensuring regular payment of the fixed dividends rather than with the value of assets. The question of capital repayment on liquidation is usually deemed to be of secondary importance to dividend maintenance.

(5) ORDINARY SHAREHOLDERS. Similarly to preference shareholders, ordinary shareholders are not greatly concerned with the actual value of assets but are interested primarily with dividend possibilities. They are also concerned with the market values of their shares, and thus desire the Balance Sheet to show the position of the company from an optimistic rather than a pessimistic standpoint.

Earning Capacity of a Business.

The true value of a business depends almost entirely upon the earning capacity of that business, i.e., the ability of the concern to make profits. To ascertain the earning power of a business, a thorough perusal of the published accounts will be of little assistance, as a Balance Sheet alone does not afford very much information as to reasons for variations in profits, etc. The profits shown in the published accounts may not be normal, but may be attributable mainly to rising or falling markets. The mere interpretation of accounts will not enable the earning power of a business to be gauged, thus it is necessary to consider, if possible, the various factors that determine earning capacity. These factors include, for example, the following :—

(1) Efficiency of works lay-out and management;
(2) Efficiency of buying department;
(3) Strength of general sales policy; and
(4) Effectiveness of financial policy.

A knowledge of the above factors as applied to any particular business, together with a thorough and correct interpretation of the published accounts under review, will afford a reasonably sound guide as to the actual financial strength of the business.

Information revealed by a Balance Sheet.

Although the preceding section indicated that a Balance Sheet does not furnish all the information required by those engaged upon the estimation of the value of a business. it must be remembered that useful information *is* afforded by a Balance Sheet. It should show on the liabilities side particulars as to capital, loans, creditors, reserves and profit and loss account balances. On the assets side will be found a varying degree of detail relating to fixed, floating and other types of assets valued in accordance with the accepted rules of valuation adopted by accountants and set out in accordance with the provisions of the Act (see pages 377 to 379).

On the other hand, those endeavouring to assess the value of a business from the balance sheet standpoint are not in possession of information on many essential points relating to the items shown in the Balance Sheet, e.g., whether the book debts include any of a large amount, whether the work-in-progress will show a profit on completion, etc. Thus it is suggested that where the "investigator" is not furnished with full information as regards the earning capacity and the detailed composition of the assets, etc., any report as to the value of the business that is drafted from a mere analysis of the published accounts should be qualified accordingly.

Form of Published Accounts.

It is now proposed to indicate the accepted principles, as laid down by the leading authorities and the provisions of the Act, to be observed in the drafting of a Balance Sheet for publication. These principles aim at making the printed document an informative statement as opposed to the misleading publications referred to earlier in this chapter.

A Balance Sheet may be defined as "a statement showing in summary form the various debit and credit balances remaining in the books at any given date, after the preparation of the Profit and Loss Account and including the balance of that account, the items in the Balance Sheet being so grouped and classified as to show clearly the financial position of the concern at the date of the statement." A Balance Sheet should not be defined as "a statement of assets and liabilities" as it contains many items, e.g., reserves, preliminary expenses, debit balance on profit and loss account, etc., which are not liabilities or assets in the accepted sense of the terms.

Grouping of Assets.

The assets may be grouped or classified either in the order of permanence or in the order of realisability, the actual method adopted depending usually upon the nature of the concern, e.g.,

a manufacturing company would probably adopt the former method and a banking company the latter. These principles are explained more fully on page 118.

Valuation of Assets.

A Balance Sheet is compiled on the assumption that the business is a going concern, and the assets should be valued on that basis. Thus the accepted theory is that fixed assets should be valued and shown in the Balance Sheet at cost price, less depreciation, whereas floating assets should be shown at the lower of cost or current market price. The question of valuation is complicated, however, by the fact that the published Balance Sheet will be read by people with widely differing viewpoints, e.g., the banker in his capacity of lender is concerned more with "break-up" values than with "going-concern" values. Furthermore, the capital of a company is assessed in the market on its earning capacity, and the real value of the assets depends on this factor. It is contended, however, that provided the basis of valuation of each group of assets is clearly indicated on the face of the Balance Sheet the statement will conform with accepted accounting principles. The Act requires that the basis of valuation of *fixed* assets must be shown, but makes no attempt to specify the basis which shall be adopted in any particular case.

Composition of a Balance Sheet (Liabilities).

It is now proposed to indicate briefly certain of the various items common to the majority of published Balance Sheets and to explain the manner in which such items should be shown.

SHARE CAPITAL. Every Balance Sheet of a company should show the nominal (or authorised) and subscribed (or called-up) capital of the company, distinguishing between Preference, Ordinary and Deferred capitals and disclosing any participating or cumulative rights. The denomination of the shares should be shown and the extent to which they are called or paid up. Calls in arrear should be shown as separate deductions from the respective classes of capital to which they refer, and calls in advance should also appear as a distinct item.

The Act provides, *inter alia*, that the Balance Sheet of a company must contain "a summary of the authorised and issued share capital."

Where a company has issued Redeemable Preference Shares under the provisions of the Act (see page 273), it must specify what part of the issued capital consists of such shares, and the date on or before which they are liable to be redeemed.

DEBENTURES. These should be shown in a similar manner to the authorised and subscribed share capital, it being indicated whether they are permanent or short-dated and whether they are secured by a specific or a floating charge. An indication of the due date of redemption of debentures is of particular importance to existent and prospective creditors and shareholders of the company concerned.

The Act provides that a company must give particulars of any redeemed debentures which can be reissued (see page 336).

MORTGAGES. Mortgages created by a concern may be shown in the Balance Sheet as deductions from the value of the assets upon which they are charged, or alternatively, may be shown on the liabilities side of the Balance Sheet.

Accrued interest on debentures, loans, etc., should be shown separately, and bank loans and advances should be kept distinct from ordinary trade creditors.

CREDIT BALANCES AND RESERVES. This item may include, in addition to sundry trade creditors, such items as depreciation or renewal reserves, amortisation reserves to provide for the expiration of leases, etc., reserves for equalisation of dividends, etc. Such a grouping, though sometimes found in the published accounts of limited companies, is far from satisfactory, and it is desirable (though not legally essential) that the item should be analysed into its component items and full disclosure made on the face of the Balance Sheet. Secured liabilities and the total indebtedness of the company to subsidiary companies *must* be shown separately, in order to comply with the Companies Act.

CONTINGENT LIABILITIES. All contingent liabilities should be noted on the face of the Balance Sheet, full provision being made in the accounts for any definite loss, as opposed to contingent losses. Among the various forms of contingent liabilities may be instanced those on bills receivable discounted, contracts of guarantee, possible law costs and damages under a pending action, forward purchases and sales, etc.

Composition of a Balance Sheet (Assets).

The Act provides that the basis of valuation of all fixed assets must be shown.

GOODWILL should not, generally speaking, appear in a Balance Sheet except when it has been purchased,

and must then always be shown specifically as a separate item. The value of goodwill fluctuates with the fortunes of its possessor, rising in periods of prosperity, and falling considerably in periods of adversity. The opinions of leading authorities differ as to the necessity of writing down goodwill, but in all cases the basis of valuation should be indicated, e.g., "at cost," or "at cost less amounts written off." The accounting treatment of goodwill in relation to partnerships is dealt with on pages 186 to 192.

FREEHOLD LAND AND BUILDINGS should usually be stated at cost unless there are very strong reasons for the adoption of another course. The value of freehold land and buildings may fluctuate considerably during the course of time, but usually the decrease in the value of the buildings by expiration of time is offset by the increase in the value of the site. Thus, it is contended that provided the buildings are kept in a sound state of repair the whole item may be retained at cost price in the Balance Sheet. The basis of valuation must be indicated.

LEASEHOLD PROPERTY, as opposed to freehold property, is subject to a definite and regular depreciation in value attributable to the effluxion of time. Thus provision must be made in this case for depreciation, the "annuity" or depreciation fund or insurance policy method being adopted where it is required to provide for the eventual replacement of the lease. The basis of valuation must be stated.

INVESTMENTS. The item of investments requires special consideration, as it embraces investments of various kinds, e.g., Government securities, municipal stocks, debentures, railway and public utility stocks, stocks in public companies of all descriptions, unquoted shares in private companies and investments in associated and subsidiary companies. The position is further complicated by the fact that the purposes for which the investments are held may be very varied. Generally speaking, investments may be classified as fixed assets provided that they perform their function of producing revenue by way of interest and dividends. From the point of view of clarity, the item of investments may be classified into its component parts as in the case of the statutory form of Balance Sheet of an assurance company. The usual practice is for this type of asset to be retained at cost in the Balance Sheet, temporary fluctuations in value being

ignored, the basis of valuation and the current aggregate market value being noted on the face of the Balance Sheet. It is advisable, of course, to adopt the usual practice of providing by way of a reserve for any permanent depreciation in value.

In the case of a holding company, the Act provides that the aggregate share-holding in subsidiary companies must be separately disclosed.

STOCK-IN-TRADE. In connection with floating assets, the particular class of asset that demands most careful valuation for Balance Sheet purposes is that which comprises stock-in-trade, work-in-progress, goods out on consignment, etc. The true results of a trading concern's activities depend to a great extent upon the basis of valuation of this asset. The customary procedure is, therefore, to describe the asset " stock " at the lower of cost or current market value, an indication being given of the person responsible for the valuation The basis of valuation of work-in-progress, etc., is explained fully in Chapter VII.

LOANS made by the company must be divided into secured and unsecured, and any loans to directors and advances to subsidiary companies must be shown as separate items. Any amounts repaid on loan account by directors must be shown (see page 276).

DEVELOPMENT EXPENDITURE. In the development of certain concerns, e.g., rubber plantations, mines, etc., considerable time and capital are expended in bringing the property to a profitable and revenue-earning condition. All expenditure incurred, including interest paid on capital (see page 346), during this development period should be capitalised and shown as a separate item on the assets side of the Balance Sheet until written off out of subsequent profits.

DISCOUNT ON SHARES AND DEBENTURES. Where debentures are issued at a discount, the amount of such discount should be written off over the term of the debentures, as it is in effect only the payment of interest at a higher rate than the nominal one appearing on the face of the debentures. Until the " asset " is extinguished, it should be shown at its original amount, less the sums written off to date.

Similarly, any discount on shares should be written off over a period. The amounts of discount on shares and debentures not written off must be disclosed separately in the Balance Sheet (see page 378).

Practical Illustration of Redrafted Balance Sheet.

In order to illustrate various points mentioned earlier in this chapter specimens are now given of two Balance Sheets, one of which is a replica of an actual balance sheet drawn up in the ordinary published form prior to the passing of the Companies Act, 1929, while the other represents the same Balance Sheet redrafted in such a way as to present the position of affairs in a more informative manner by means of a classification of assets and liabilities, etc. The redrafted Balance Sheet is framed with a view to emphasising in particular two important points, viz. :—

(1) The amount of working capital available ; and

(2) The manner in which the shareholders' "equity" (i.e., Share Capital *plus* Profit and Loss balance *plus* any Reserves representing undivided profits) is represented by Net Tangible Assets, Intangible Assets and Fictitious Assets respectively.

(1) **Published Form of Balance Sheet** (prior to passing of Companies Act, 1929).

X Company, Limited.

BALANCE SHEET

AS AT 31ST DECEMBER, 19..

Liabilities.		£	£
Share Capital :—			
Authorised—			
200,000 7% Preference Shares of £1 each		200,000	
200,000 Ordinary Shares of £1 each		200,000	
		£400,000	
Issued—			
150,000 7% Preference Shares of £1 each, fully paid	150,000		
Less 100 Shares forfeited	100		
		149,900	
100,000 Ordinary Shares of £1 each, fully paid		100,000	
			249,900
6% Debenture Stock— Authorised		£150,000	
Issued		130,000	
Less Redeemed		30,000	
			100,000
Sundry Creditors and Credit Balances			66,300
Reserve for Depreciation of Fixed Assets			70,000
Reserve for Bad and Doubtful Debts			6,000
Debenture Stock Sinking Fund			30,000
Leasehold Sinking Fund			3,000
Forfeited Shares Account			75
Reserve Fund			50,000
Profit and Loss Account			65,000
			£640,275

Assets	£
Freehold and Leasehold Premises, Plant, Machinery, Patents, Fixtures and Goodwill	350,000
Investments	100,000
Stock-in-trade	67,085
Sundry Debtors and Debit Balances	100,700
Cash in hand and at Bank	2,490
Preliminary Expenses	7,000
Discount on Debenture Stock	13,000
	£640,275

(2) Redrafted Form of Balance Sheet.

X Company, Limited.

BALANCE SHEET

AS AT 31ST DECEMBER, 19..

Capital, Liabilities and Credit Balances.

		£	£
SHARE CAPITAL:—			
Authorised—			
200,000 7% Preference Shares of £1 each		200,000	
200,000 Ordinary Shares of £1 each		200,000	
		£400,000	
Issued—			
150,000 7% Preference Shares of £1 each, fully paid		150,000	
Less 100 Shares forfeited		100	
		149,900	
100,000 Ordinary Shares of £1 each, fully paid		100,000	
			249,900
(50,000 Ordinary Shares are under option for subscription at par until—).			
RESERVES:—			
Amount received on Forfeited Shares		75	
Debenture Stock Redemption Fund		30,000	
General Reserve Account		50,000	
			80,075
PROFIT AND LOSS ACCOUNT:—			
Amount brought forward		30,000	
Add Net Profit for Year		96,493	
		126,493	
Less Preference Dividend for Year	10,493		
Final Ordinary Dividend 20%	20,000		
Interim Ordinary Dividened 10%	10,000		
Reserve Account	21,000		
		61,493	
			65,000
"Equity" of Shareholders			394,975
FUNDED DEBT:—			
6% Debenture Stock, 1940—			
Authorised	£150,000		
Issued	130,000		
Less Redeemed	30,000		
		100,000	
CURRENT LIABILITIES:—			
Trade Creditors	40,000		
Bills Payable	18,000		
Trade Expenses	2,300		
Debenture Interest accrued	6,000		
		66,300	
Total External Liabilities			166,300
			£561,275

Assets and Debit Balances.

	£	£	£
FIXED ASSETS —			
Freehold Premises at cost		30,000	
Leasehold Premises at cost	30,000		
Less Leasehold Redemption Account	3,000		
		27,000	
Plant and Machinery as at 1st January, 19.., at cost, less £50,000 depreciation	200,000		
Less Depreciation for year	50,000		
		150,000	
Fixtures and Fittings as at 1st January, 19.., at cost	10,000		
Less Depreciation	2,000	8,000	
Investments in Trustee Securities, on account of Debenture Stock Redemption Fund, at cost		30,000	
Investments in Subsidiary Companies at cost (Approximate current valuation, £43,000)		50,000	
			295,000
FLOATING ASSETS:—			
Investments in Trustee Securities at cost (current market valuation, £17,500)		20,000	
Stock-in-Trade and Work-in-Progress (as valued by Works Manager)		67,085	
Sundry Debtors—			
On Open Accounts	60,000		
Bills Receivable	38,000		
	98,000		
Less Reserve for Bad and Doubtful Debts	6,000		
		92,000	
Trade Expenses paid in Advance		2,700	
Cash at Bank	2,400		
Cash in hand	90		
		2,490	
			184,275
Total Tangible Assets			479,275
INTANGIBLE ASSETS:—			
Goodwill at cost		50,000	
Patent Rights at cost	30,000		
Less Amount written off	18,000		
		12,000	
			62,000
FICTITIOUS ASSETS:—			
Preliminary Expenses at cost	14,000		
Less Amount written off	7,000		
		7,000	
Discount on Debentures as at 1st January, 19..	14,000		
Less Amount written off	1,000		
		13,000	
			20,000
			£561,275

It will be observed that the above redrafted Balance Sheet has been constructed with a view to distinguishing on the left-hand side between the external liabilities (both short-dated and long-dated) and what may be termed the "internal" liabilities (i.e., to shareholders) and reserves; for this purpose accrued debenture interest, which is frequently shown as an addition to the principal outstanding, has been grouped with the short-dated liabilities. In addition, the various items which make up the shareholders' "equity" in the company have been grouped together.

The assets side has been made more informative and clearly indicates both the composition and the gross totals of tangible, intangible and fictitious assets. In this way interested parties can readily ascertain the amount of the working capital (Floating Assets, £184,275, *less* Current External Liabilities, £66,300 = £117,975). In addition, it can be seen that the Shareholders' "equity" of £394,975 is represented by:—

	£
Net Tangible Assets [Total Tangible Assets, £479,275, *less* Total External Liabilities, £166,300]	312,975
Intangible Assets	62,000
Fictitious Assets	20,000
	£394,975

The question of how much of this sum is applicable to the Preference and Ordinary shareholders respectively depends on the rights attached to each class of share (e.g., as to whether the Preference Shares are entitled to participate in any surplus in a winding-up).

It has been suggested by Lord Plender, G.B.E., LL.B., F.C.A., that the annual accounts submitted to the members of a limited company might usefully be supplemented by a comparative statement of the position of the company as shown by the last (say) five Balance Sheets, in a form which could be readily comprehended by all members, even those with little or no knowledge of accountancy. A suggested ruling of this statement is as follows:—

	Year 19..	Year 19..	Year 19..	Year 19..	Year 19..
	£	£	£	£	£
Total fixed assets (stating separately tangible and intangible assets) less depreciation provisions, as shown by Balance Sheet, at end of year					
Total floating assets, as shown by Balance Sheet, at end of year					
Deduct:					
Total liabilities (excluding Debentures) and specific provisions, as shown by Balance Sheet, at end of year					
Excess of assets over liabilities and specific provisions					
This is represented by :—					
Total Debenture issues . . .					
Total Issued Share Capital . . .					
Total of the General or Free Reserves (including balance of Profit and Loss Account)					
Profit for year available for dividend .					
Profit distributed in dividends (Preference and Ordinary) in respect of year . .					
Rate per cent. of dividend paid on Ordinary Share Capital	%	%	%	%	%
Balance of Profit and Loss Account carried forward to next year					

Criticism of Balance Sheets.

The criticism of Balance Sheets or of published accounts is a wide subject embracing the whole field of accountancy. In practice, criticism becomes necessary under various circumstances, among which are the following :—

(1) On the sale of a business or the admission of a new partner.
(2) On a company proposing to take over an existing undertaking.
(3) On an investor wishing to decide whether to purchase a certain commercial security.
(4) On a shareholder wishing to determine whether to increase or reduce his holding.
(5) On a creditor (or prospective creditor) wishing to determine the security for his claim.

In examining a Balance Sheet critically it must be considered from all points of view and the examiner should at the outset ask himself such questions as the following :—

(1) Is the business carried on likely to be a permanent one ?
(2) Is it likely to continue as a going concern ?
(3) Is it working a wasting asset ?
(4) Is it exploiting a novelty, the popularity of which is likely to wane ?

Criticism of Various Items in a Balance Sheet.

In the following paragraphs are set out the principal points that should arise in the mind of a person engaged in the criticism of a Balance Sheet as regards the items that are common to the majority of those published.

SHARE CAPITAL.

(1) Classes of share capital, their rights and priorities, and date of redemption of redeemable preference capital.
(2) Ratios of nominal, subscribed and paid-up capital.
(3) Amount of any uncalled capital and reserve capital.
(4) Calls in arrear, treatment thereof, and possibility of recovery.
(5) Arrears of dividend on cumulative preference shares.
(6) Amount of forfeited shares and treatment of any profit on reissue.

Of the above items (5) is of particular importance to a prospective investor in ordinary shares, as such arrears will normally have to be made good before a dividend can be declared on the ordinary shares.

DEBENTURES.

(1) Terms of issue and date of redemption.
(2) Treatment of any premiums or discounts on issue.
(3) Nature of charge, fixed or floating.
(4) Margin of security and interest accrued but unpaid.
(5) Provision for repayment.
(6) Extent of collateral issues.
(7) Amount of redeemed debentures available for reissue.

SUNDRY CREDITORS.

(1) Detailed composition of this item, specifying in particular loans from directors and subsidiary companies.
(2) Customary terms of credit.
(3) Nature of security (if any) held by creditors.
(4) Ratio of creditors to capital employed and to floating assets.
(5) Amount of working capital, i.e., excess of floating assets over current external liabilities.

BILLS PAYABLE.

(1) Unexpired term to run.
(2) Details of any "finance" bills.

BANK LOANS AND OVERDRAFTS.

(1) Provisions *re* interest, repayment and limit available.
(2) Nature of security.
(3) Reason for obtaining loans.

RESERVES.

(1) Detailed composition of item "reserves."
(2) Manner in which reserves employed, whether locked up in plant, etc., or invested in marketable securities.
(3) Current market value of investments earmarked for reserves.

PROFIT AND LOSS ACCOUNT BALANCE.

(1) Details of balance brought forward, net profit or loss for current year, appropriations to reserve, etc., dividend payments.
(2) Ratio of net profit to capital.
(3) Ratio of net profit to average of preceding years.

GOODWILL.

(1) Origin, excess of purchase consideration over net assets acquired or specially computed.
(2) Basis of valuation.
(3) Ratio to average net profits and average "super" profits.
(4) Amount of patents and trade marks, if merged with goodwill.

LAND AND BUILDINGS.

(1) Detailed composition and general location.
(2) Basis of valuation.
(3) Terms of leases, provisions for renewal and possible liability for dilapidations.
(4) Trend of values and degree of realisability.

PLANT AND MACHINERY.

(1) Detailed composition and probable term of utility.
(2) Basis of valuation.
(3) Provision for repairs and replacement.
(4) Present degree of realisability.

STOCK.

(1) Nature, raw materials, work-in-progress, finished goods.
(2) Basis of valuation and by whom valued.
(3) Ratio to turnover.

SUNDRY DEBTORS.

(1) Detailed composition, trade debts, loans, etc.
(2) Reserves for bad and doubtful debts.
(3) Usual terms of credit.
(4) Ratio to turnover.
(5) Ratio to sundry creditors.

BILLS RECEIVABLE.

(1) Unexpired term to run.
(2) Stability of acceptor.
(3) Reserves for doubtful bills.
(4) Contingent liability for discounted bills.

INVESTMENTS.

(1) Detailed composition of investments, whether in quoted or unquoted securities, associated and subsidiary companies, etc.
(2) Object of investments, sinking funds, etc.
(3) Basis of valuation, ratio of book value to current market value.
(4) Ratio of income yield.
(5) Contingent liability for uncalled amounts.

LOANS.

(1) Detailed composition, specifying in particular loans to directors or subsidiary companies.
(2) Nature and margin of security.
(3) Ratio of interest.
(4) Amount of accrued interest, specifying arrears.
(5) Reserves for possible losses where margin inadequate.

PATENTS, TRADE MARKS, ETC.

(1) Origin, created or acquired by assignment.
(2) Basis of valuation.
(3) Unexpired term.

PRELIMINARY EXPENSES.

(1) Detailed composition and date when incurred.
(2) Provisions for writing off.

Deductions from Comparative Balance Sheet.

The actual information obtainable from a detailed criticism of a single Balance Sheet is limited, and where possible the investigator should endeavour to draw his deductions from a series of Balance Sheets, e.g., from the Balance Sheets of the last three to seven years. Where this comparative method is adopted, various deductions, among which are the following, can be made :—

(1) If share or loan capital is frequently increased without a corresponding increase in turnover a weak financial position is indicated.

(2) If bank loans are retained for considerable periods it is indicated that the revenue-earning capacity of the company is inadequate to justify an increase of share capital.

(3) If profits are comparatively stable over a period of years, and approximate to the average of such years, it is indicated that profits will not fluctuate provided normal conditions are maintained.

(4) If dividends are maintained and regular appropriations made to reserve and the working capital remains stable, steady and satisfactory progress is evident.

(5) If profits are gradually increased without a corresponding increase in floating assets, viz., debtors, stocks, etc., greater productive efficiency and/or improved selling prices are indicated.

(6) If profits are gradually increased with a corresponding increase in debtors, stocks, etc., an increased turnover is indicated.

(7) If work-in-progress and stocks are subject to wide fluctuations the existence of large contracts requiring lengthy periods for completion is indicated.

(8) If fixed assets are increasing in value without a corresponding increase in profits, inadequate provision for depreciation and overvaluation of fixed assets is indicated.

(9) If creditors are gradually exceeding debtors, without a corresponding increase in stocks, over-trading is indicated where profits are maintained, whereas a possibility of compulsory liquidation is indicated where profits are non-existent.

The above examples of the more usual deductions cannot be applied without modification to every individual concern, as consideration must be given to any circumstances peculiar to the business under review.

ORGANISATION OF ACCOUNTS AND INTERNAL CHECKS

It is becoming quite a common feature for questions to be included in professional examination papers on the organisation of accounts and systems of internal check. Questions of this nature give the examinee an opportunity of showing that his knowledge is both practical and up to date. The rules which follow will serve as a general guide as to what are considered by experienced accountants to be the most important and effective methods to be adopted to ensure the prevention of the falsification of accounts with a view to the misappropriation of money or goods.

As many persons as possible should take part in each department of the work, in order to provide sufficient safeguard against error and to lessen the risk of fraud by increasing the number of people who would have to be working in collusion.

Entries recording the receipt of cash, or its transference from one member of the staff to another, should bear the initials of the receiver in order to fix responsibility.

All " trade " accounts should be systematically checked by independent persons before payment, to verify the accuracy of quantities, qualities and prices, and to ensure that the proper trade and cash discounts are taken.

Vouchers (which should *not* be on a printed form sent out by the business) should be required for all payments (including petty cash transactions above a certain amount, but excepting wages). The vouchers should be numbered consecutively and filed in the same order as that in which the corresponding items appear in the cash book, and should be compared (by someone other than the cashier) with the amounts charged in the cash book. Payments by cheque should be made on a fixed day. The cashier should check the statements and draw the cheques, the checked statements (with documents in support) being placed subsequently before a responsible official along with the cheques to be signed.

Notice should be given on invoices or statements that cheques should be made payable to the concern and crossed to the concern's bankers, and that no receipt will be recognised unless issued on the official printed form. Copies of receipts are best made by means of carbon paper in an interleaved book so arranged that a receipt and its copy bear the same progressive number; counterfoils involve risk of error and fraud. The copy receipts should be compared with the cash book by an independent person. The reserve supply of receipt books should be kept under lock and key by a responsible person, and old receipt books should be examined to see that the sequence of numbers is unbroken and that each page bears the initials of the person who has checked the copy receipt.

It is not desirable that travellers should collect moneys, and all remittances should be made direct to the concern, but where the transactions are with small traders or private persons it is sometimes impossible to prohibit travellers from handling money, in which case precautions such as the following should be adopted and strictly observed :—

(1) Full lists of items must accompany the gross daily remittances, and no deduction for any purpose should be allowed.

(2) Receipt books should be submitted weekly for inspection, different books being used on alternate weeks.

(3) Credit allowed to customers should be limited, and if

payment is not made according to arrangement and no satisfactory explanation is received from the customer, application for payment should be made direct.

(4) To prevent collusion, the cashier should not be allowed to check the travellers' statements with the counterfoils, cash book or ledger; an independent person should undertake this work.

All cash receipts should be paid into the bank without deduction, and on the same day as received if possible, and any person receiving money should be prohibited from making any payment therefrom.

Petty Cash should be kept on the imprest system.

All cash balances should be systematically verified daily and a permanent record kept in a Balance Book of the total balance. Any IOU forming part of a balance should be scrutinised and the authority for its acceptance verified.

The balance of the Bank Pass Book should be agreed frequently with the bank columns in the cash book, by means of a reconciliation statement, this being carried out by some person other than the cashier.

Salary lists should be certified by the principal, manager, secretary, director or chief clerk, and a cheque drawn for the total amount, or for each salary if paid monthly.

To keep watch upon the amount of wages to be paid, and to prevent fraud by the inclusion of "dummy" workmen, a reliable system of check should be used in conjunction with a time indicator and the sheets filled up by the foreman.

It is of great importance that each stage of the work in connection with the calculation, preparation and payment of wages should be carried out by different persons, and a list of the different steps should be stamped with a rubber stamp at the foot of the wages book so that each person can initial in respect of that part of the work for which he is responsible. The timekeeper's book will contain particulars of the time worked by each man, his rate of pay, overtime at extra rates, analysis between different jobs, deduction (*e.g.* national insurance and income tax), and the net amount due. This record should be checked in the office by one clerk, and the wages book written up from it by another; the totals of the two books should, of course, be in agreement. A certificate of the total amount due may then be handed to the cashier by the manager or secretary as his authority for drawing the cheque. Slips may be prepared (by different clerks) showing each man's name and/or number, and the amount

due to him. A slip is then handed to each man by a junior clerk in the presence of the foreman or timekeeper, and the payment is made when the slip is presented to the pay clerk. Unclaimed slips should be returned to the office for record and adjustment purposes. It is advisable that the actual payment of wages be supervised by a responsible official.

Orders for goods and materials purchased should be given only by persons specially authorised, and, in a large business, printed forms numbered progressively should be used. These forms should be bound up in books so that carbon copies may be retained, as described in the case of receipts, thus enabling the manager or principal to have quantities and prices available for reference. Particulars of goods received should be entered in the stock book (the form of which is described later). Invoices for goods received should first be compared with the order and stock books, and, after the calculations have been checked, initialled by some responsible person preparatory to being entered in the purchase book, and duly filed.

Purchases returns should be entered from an advice note furnished by the departmental manager, and checked with the credit note, when received.

The form of stock book described below is intended to ensure that no goods leave the premises without being charged up as sales, or otherwise accounted for.

Orders received for goods to be sold should be numbered progressively and recorded in the order book as soon as received, afterwards being filed away. The order book should be compared with the copies of delivery notes and with any remarks made on the orders by the forwarding department, so that it may contain full particulars. The sales book is then entered up from the order book and checked, so that the invoices may be prepared. A more modern system is to dispense with the sales book by using a carbon book and writing out the invoices direct from the order book, the posting being done direct from the carbon copies. All calculations, extensions and totals appearing on an invoice must be checked before the transaction is posted.

Sales returns should be checked by an independent person, particulars entered in the stock book and returns book, and a credit note sent to the customer.

If the kinds of goods dealt in are of varied character it is best to keep one stock book in debit and credit form, entered up by the storekeeper or warehouse clerk and containing a detailed record of all inward and outward movements of stock.

If several well-defined classes of goods are dealt in or manufactured (e.g., books, clothing, and furniture) separate " accounts " in the same form can be kept for each department in the stock book, or separate books can be kept, if advisable. A General Stock Book will reveal approximately the stock on hand by taking the difference between its two sides ; similarly, if separate stock " accounts " or books are kept, the stock of each kind of goods can be ascertained, which information will be helpful in controlling stocks, particularly if the book values are checked physically at frequent intervals. In a large business, everything passing inwards or outwards, or between departments, can be made to pass through the general receiving and forwarding departments, so that a check can be kept upon the departmental stock accounts, and any leakage or irregularity located. Of course, a reasonable margin would have to be allowed at stocktaking to cover the unavoidable waste in handling, making up, etc.

As many persons as possible should share the responsibility of keeping stock. Similarly, the work of stock-taking should be divided amongst several persons, e.g., one to call out the goods, another to enter up, a third to fix the price (usually either the purchase or current market price, whichever is the lower), a fourth to make the extensions and totals, and a fifth to check the prices and calculations.

In addition to the adoption of self-balancing principles, each ledger clerk should be held solely responsible for the ledger under his care ; no other person should make entries therein, nor should the ledger clerk be allowed to make entries in any other book. Detailed postings should be checked by someone other than the ledger clerk who made them. Balances should be extracted frequently, e.g., monthly, and agreed with those of the respective adjustment accounts. Ledgers should be exchanged every few months, so that no single clerk may have an opportunity for extensive falsification.

Transfers between ledgers should be passed through a transfer journal. A test journal (or check ledger) is used for extracting the total balance of each ledger, which should, of course, agree with the sum of the separate balances. No posting should be made except from a book of first entry ; if any adjustment or allowance is to be made, and it cannot be passed through the journal, it should be clearly shown in the ledger and initialled by the person who authorised it.

If loose-leaf ledgers are used, the stock of blank sheets should (to prevent substitution) be in the charge of a responsible person, and each clerk should be required to sign a voucher for all the sheets he receives.

EXERCISE 19.

A. Define a Balance Sheet, and state why in the majority of instances it is not a statement of Liabilities and Assets.

B. State the parties usually interested in the interpretation of published accounts and differentiate between their viewpoints.

C. Discuss the inadvisability of the adoption of the practice of grouping unrelated assets under one head.

D. What do you understand by the "earning capacity" of a business? Will a perusal of the published accounts of a business afford sufficient information to enable the "earning capacity" of that business to be gauged?

E. State the principles upon which you would marshal the assets and liabilities in the Balance Sheet of a limited company, giving reasons for the basis you adopt.

F. Express fully your opinion upon the methods of grouping items under general headings in a Balance Sheet, and state what distinction you would make between realisable assets and debit balances of a suspense nature. Give examples

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G. Define the following terms: Fixed assets; Floating assets; Fictitious assets; and Intangible expenditure.

H. When preparing a Balance Sheet upon what principles should the various items be valued? Give examples and full reasons for your answer.

I. The form of recently published Balance Sheets of certain companies is entirely different from those published prior to the Companies Act, 1929. Give your reasons for this, indicating in what directions amendments have appeared.

J. What do you understand by the phrase "the working capital of a company"? Set out with imaginary figures how it could be shown in the accounts published for the information of shareholders.

K. The undermentioned assets are the property of the Reliance Boot Manufacturing Co., Ltd. How should they be valued for Balance Sheet purposes?

(*a*) Twenty debentures of £100 each in the Brighter Gas Corporation, representing the investment of the Reserve Fund. The debentures were purchased at par, but the market price had since fluctuated

between 97 and 104, the former quotation being the market price at the date upon which the Balance Sheet of the Reliance Co. is prepared.

(*b*) Patents, £2,000. This amount represents the original cost of the patent rights in a welting machine. The grant of letters patent is dated eight years ago.

(*c*) Goodwill, £5,000. This asset was purchased nine years ago, at the price named, upon the formation of the company. The trading profits have steadily declined from £4,100 to £2,000 in the last nine years.

L. In your opinion, is it necessary for the directors of a Limited Company to deal with contingent liabilities when preparing the annual accounts ?

If you consider that such an obligation exists, select two liabilities of this nature, and show by means of a *pro forma* Balance Sheet how you would require them to be recorded in accounts you are asked to certify.

M. It is sometimes stated that the Balance Sheets of public companies are prepared and presented in such a form that the true position of the Company cannot readily be ascertained. In order to avoid such a criticism, state your views as to the proper method of dealing with the following items in a Balance Sheet:—

(*a*) Investments in Government Securities.
(*b*) Investments in Subsidiary Companies.
(*c*) Cash Loans owing to the Company.
(*d*) Contingent Liabilities.
(*e*) Reserve Funds and Reserve Accounts.

N. "The value of the goodwill of a business usually fluctuates in sympathy with the commercial success of the undertaking."

Comment on this statement, and give your opinion as to whether such fluctuations should be recorded in the accounts of the concern.

O. Indicate the principal circumstances under which the criticism of a Balance Sheet becomes necessary.

P. Compare the value of the information obtained from an examination of a single Balance Sheet with that obtained from a series of Balance Sheets.

Q. A manufacturer has before him a copy of the last published accounts of the Gordon Co., Ltd. He is desirous of satisfying himself that it would be reasonable for him to give them credit up to £1,000. To what points in the accounts should he direct his attention ?

R. Draft a scheme of organisation for the accounts of any business with which you are acquainted.

S. The following items are taken from a Company's Books at 31st December, 1940:—

	£
Discount on Debenture Stock	10,000
Leasehold Sinking Fund	4,000
Furniture and Fittings, *less* Depreciation	10,000
Investments in Associated and Subsidiary Companies, at cost	142,000
Investments in Marketable Securities	48,000
Cost of Freehold and Leasehold Premises, Plant and Machinery	400,000
Share Capital Authorised:—	
200,000 6 per cent. Preference Shares of £1 each	200,000
300,000 Ordinary Shares of £1 each	300,000
Stock-in-Trade and Work-in-Progress	60,000
Book Debts and Expenditure in Advance	70,000
6 per cent. 5 year Notes and Interest accrued	31,000
Sundry Creditors and Accrued Expenses	22,000
Reserve Fund	40,000
Loan on Security of certain Investments	20,000
Share Capital Issued:—	
160,000 6 per cent. Preference Shares of £1 each	160,000
280,000 Ordinary Shares of £1 each	280,000
Amount paid on Forfeited Shares	50
Profit and Loss Account (Credit Balance)	70,000
Reserve for Depreciation of Premises and Plant (of which £18,000 represents provision made during the year under review)	96,000
Bills Receivable	18,000
Reserve for Bad and Doubtful Debts	2,000
Debenture Stock Sinking Fund	25,000
Preliminary Expenses	15,000
Cash at Bank and in Hand	5,050
5 per cent. Debenture Stock:—	
Authorised	200,000
Issued	175,000
Redeemed	25,000
Interest Accrued	3,000
Bills Payable	15,000
Loose Tools	40,000
Goodwill and Patent Rights	100,000

Notes.—(1) The market value of the Investments (other than those in Associated and Subsidiary Companies) at 31st December, 1940, was £45,000.

(2) The valuation of Loose Tools was made by officials of the Company.

(3) 20,000 Ordinary Shares were under option for subscription at par until 31st December, 1944.

Draft a Balance Sheet in proper form assuming the further information (if any) you would require.

T. The Secretary to a Company hands to you for investigation the following Balance Sheet :—

THE HOSIERY MANUFACTURING CO., LTD.

STATEMENT TO 31ST DECEMBER, 19...

	£		£
Shareholders	60,000	Premises, Machinery and Goodwill	55.000
Debenture-holders	10,000	Stock and Consignments	4,839
Balance at Bank	2,483	Shareholders for amounts called up	11,265
Debts, *less* amount owed	10,376	Debentures of the Company bought	945
		Furniture, Fittings and Stationery	871
		Preliminary Expenses	1,249
		Shares in "Hosiery Marketing Co., Ltd."	800
		Bills Receivable, *less* Bills Discounted	2,843
		Advertising Contract	350
		Balance of Revenue	4,697
	£82,859		£82,859

Give your comments, redraft the Balance Sheet (assuming figures where necessary), and say how each item should be valued.

U. The following Balance Sheet was issued by the Priory Co., Ltd. :—

BALANCE SHEET

AS AT 31ST DECEMBER, 19...

Liabilities.	£	£	*Assets.*	£	£
Issued Share Capital	190,000		Leasehold Land, Buildings and Machinery at cost		150,000
Less Calls in Arrear	8,000		Railway, Wharf, Motor Boats and Live Stock, etc., at cost	12,000	
		182,000	*Less* Depreciation	500	
Bank Loan		48,000			11,500
Sundry Creditors		3,647	Stocks-on-hand		48,400
Bills Payable		32,100	Contracts not completed and Work-in-progress		50,685
Profit and Loss Account—			Advances to Employees and Sundry Debtors		7,150
Profit for the Year	9,120		Suspense Account		92
Less Interim Dividend paid	9,100		Cash in hand	850	
		20	Cash at bank	2,090	
Depreciation Fund		5,000			2,940
		£270,767			£270,767

You are asked to criticise this Balance Sheet from the point of view of a prospective shareholder. If you desire any further information before giving your opinion, submit the letter which you would address to the secretary of the company.

V. The understated Balance Sheet has been submitted to you for examination. If you do not approve, criticise and amend it, assuming figures where necessary.

BALANCE SHEET

FOR THE YEAR ENDING 31ST DECEMBER, 19...

	£	£		£
Capital:—			Leasehold Factory	15,342
50,000 Ordinary Shares of £1 each	50,000		Plant, Machinery and Loose Tools	22,461
Less Uncalled	6,250		Stock and Work-in-Progress (*Less* Payments in Advance from Customers)	10,872
	43,750		Loans to Manager and Directors	1,550
Unpaid Calls (*Less* Calls in Advance)	100		Current Expenses in Advance	375
		43,650	Claims Payable under Fire Policy	1,562
Shares Forfeited and Reissued		300	Sundry Debtors (*Less* Discount)	8,520
Creditors, Reserve, Bills Payable and Credit Balances		12,872	Furniture, Patterns, Patents and Trade Marks	4,542
Depreciation, Fire Insurance and Bad Debt Reserves		3,750		
Bank Loan (*Less* Current Account)		4,652		
		£65,224		£65,224

W. The following is submitted to you as the Balance Sheet of the Elastic Trading Company, Ltd :—

BALANCE SHEET

FOR THE YEAR ENDED 31ST MARCH, 19..

Liabilities.		£	*Assets.*	£
Nominal Capital:—			Cash in Hand	50
200,000 7% Cum. Pref. Shares of £1 each		200,000	Stock-in-Trade (valued by Manager at Current Selling Price)	25,000
250,000 Ordinary Shares of £1 each		250,000	Freehold Premises, Furniture, Fittings and Fixtures, Plant and Machinery	70,000
		450,000	Leasehold Premises, Goodwill, Investments, Trade Marks and Shares in Subsidiary Company	83,400
Sundry Creditors (including Bank Balance)		15,000	Sundry Debtors (including Uncalled Capital, Calls in Arrear and Sundry Shareholders' Dividend Account)	290,550
Reserve for Bad and Doubtful Debts		500		
Profit and Loss Account—	£			
Balance for period	7,000			
Less Preference Dividend declared but not yet paid	3,500			
		3,500		
		£469,000		£469,000

The issued capital of the Company is 100,000 7 per cent. Cumulative Preference Shares of £1 each fully paid and 150,000 Ordinary Shares of £1 each, 10s. called. 2s. 6d. per share on 400 Ordinary Shares is in arrear.

The shares held in the Subsidiary Company are £1 Ordinary Shares upon which 15s. per share has been paid up, the balance remaining uncalled.

Criticise this Balance Sheet in detail and, if you consider it incorrectly drawn, redraft it in proper form using imaginary figures where figures are not given or are unascertainable from the information supplied.

Appendix I. PRO FORMA

SHOWING REQUIREMENTS OF COMPANIES

SEC.	*Liabilities.*	£ s. d.	£ s. d.
	SHARE CAPITAL		
	Authorised—		
124(1)	Preference		
124(1) 46	Redeemable Preference		
124(1)	Ordinary		
124(1)	Deferred		
	Issued—		
124(1)	Preference		
124(1) 46(2)	Redeemable Preference . . . . (*with indication of date of redemption.*)		
124(1)	Ordinary		
124(1)	Deferred		
54	Capital on which interest is being paid pending completion of construction; etc., indicating rate of interest . . . . (*Maximum rate of interest increased by Companies (Interest out of Capital) Order,* 1929, *to* 6% *per annum.*)		
75(3)	DEBENTURES (*with indication of redeemed debentures that may be reissued.*)		
	SUNDRY CREDITORS		
124(1)	Trade Creditors		
124(3)	Secured Creditors . . . . (*not necessary to specify nature of security.*)		
125	Subsidiary Companies . . . . . . (*in aggregate, advisable to include note of liability on debentures.*)		
	Other Creditors . . . . (*indicating general nature thereof.*)		
123(2)	RESERVE FUND, GENERAL RESERVE OR RESERVE ACCOUNT		
46(1)	CAPITAL REDEMPTION RESERVE FUND .		
	PROFIT AND LOSS ACCOUNT . . .		
	AUDITOR'S REPORT to Members to be *attached* to the Balance Sheet S.129 (1).		
		£	

BALANCE SHEET.

ACT, 1929, AS TO DISCLOSURE

SEC.	*Assets.*	£ s. d.	£ s. d.
124(2)	GOODWILL, PATENTS AND TRADE MARKS (*if ascertainable and so far as not yet written off.*)		
124(1)	FIXED ASSETS (*indicating general nature and stating how valued.*)		
125	Shares in Subsidiary Companies . . . (*in aggregate, advisable to include aggregate amount of debentures in subsidiary companies separately.*)		
124(1)	FLOATING ASSETS . . . . . . (*indicating general nature.*)		
125	Amounts owing by Subsidiary Companies . (*in aggregate.*)		
	Trade Debtors		
128(1)	Loans to Directors or Officers of Company . (*in aggregate, showing loans made and repaid during period and prior loans still outstanding, with note of loans made by any other person under guarantee of company.*) *Exceptions:* (1) *Loans made by companies in ordinary course of business, where business includes lending of money.* (2) *Loans under £2000 to employees in accordance with adopted practice.*		
45(2)	Loans by Company . . . . . . (*in aggregate, for purchase of fully-paid shares by or for benefit of employees.*)		
	Other Debtors		
	Investments . . . . (*held as floating assets, if doubtful, treat as fixed assets and show how valued.*)		
	Stock-in-Trade		
	Cash Balances	———	
124(2)	PRELIMINARY EXPENSES . . . . (*so far as not yet written off.*)		
124(2)	EXPENSES OF ISSUE OF SHARES AND DEBENTURES . . . . . (*so far as not yet written off.*)		
44(1)	COMMISSIONS PAID ON SHARES AND DEBENTURES AND DISCOUNT ON DEBENTURES . . . . (*so far as not yet written off.*)		
47(3)	DISCOUNT ON SHARES ISSUED . . . (*so far as not yet written off.*)		
	Balance Sheet to be signed by two Directors. S.129 (1). Statement signed by above Directors re Profits and Losses of Subsidiary Companies. S.126 (1).		
		£	

Appendix II.

PURCHASE TAX: ACCOUNTING ENTRIES

Purchase Tax became chargeable on 21st October 1940, and the introduction of this new form of taxation has necessitated certain alterations in the accounting methods of registered manufacturers and wholesale merchants. Until further practical experience has been obtained, it is not possible to foresee all the complications which will arise, but the suggestions made below summarise the specialised accounting features arising out of the tax.

Sales.—It is essential that the amount of the tax should be shown separately on invoices for goods supplied by registered firms to retailers, and a convenient form is as follows :—

Invoice or Statement

	£ s. d.	
Chargeable goods (described in detail) .		
Delivery (if charged separately) . .		
Packing and use of container (if charged separately)		
		(a)
Deduct Cash discount (subject to payment on or before (a)) .		
Net Total		
Purchase Tax at % on Net Total .		(b)
Total Payable	£	

The same particulars should be given on copies of the invoice retained for reference. Where the charge to the retailer (i.e. (a) above) differs from the amount on which tax is due (through adjustments for notional values, containers and delivery charges) it may be more convenient to add to the invoice a statement showing the calculations of the tax. If the customer is being supplied with goods chargeable at the full rate of tax, with goods chargeable at the half-rate and with exempt goods, it may be desirable to send separate statements for each class of goods and to provide a separate tax column in the statement.

If the invoice is prepared in this way, it will be possible to write up the Sales Day Book, which will normally have columns for the items marked (a) and (b) in the form above. In any case, the Commissioners of Customs and Excise recommend that there should be a separate column showing the tax charged to the buyer. Similarly in the Returns Inwards Book there should be a column showing tax credited in respect of goods returned or other allowable credits ; in order that the credits may be properly vouched, the credit notes should give particulars of the tax adjustment. If sales or credits are passed through in respect of exempt sales (to another registered firm or to a Government department on a tax-free basis) there will, of course, be no entry in the tax column, and it is suggested that in these cases the registered number of the buyer or the serial number of the Government contract or order should be noted in the Sales Day Book or Returns Inwards Book for record purposes.

When payment is received on an invoice or statement, the amount received in respect of tax should be shown in a separate column in the Cash Book, viz.:

CASH BOOK (Debit side)

Date.	Name.	Discount.	Cash.	Bank.	Sales Ledger. Goods.	Sales Ledger. Tax.
		£	£	£	£	£
Dec. 1	J. Jones	6	44	..	39	11

The Sales Ledgers will be written up in the usual way, though in some cases it may be found convenient to have a separate tax column, or even separate tax ledgers, to facilitate reconciliation at the end of financial periods.

PURCHASES.—The Commissioners require that "all chargeable goods received or purchased tax-free from other registered firms or from abroad must be recorded as such and that the seller's name and address or the importation particulars must be traceable if required." In practice, the trade purchases of registered firms will be made tax-free, with few exceptions, and no alterations will be necessary in the design of the Purchase Day Book, provided that the required particulars are shown. It should be noted, however, that such tax-free purchases include only goods required or material for use in manufacture or as stock for wholesale trading: other purchases (e.g., office stationery or equipment for the firm's own use) will be made with tax added and will normally be passed through as trade expenses at the gross amount payable.

OTHER RECORDS.—It is provided that "in the case of a manufacturer, his records should contain particulars of all chargeable goods manufactured." The precise implications are not clear, but it is probable that in most cases the normal production records will suffice.

Other records and documents which should be kept include (*a*) copies of invoices and statements, (*b*) orders for goods supplied and other registered buyers, (*c*) Government tax-free contracts or orders, (*d*) importation and exportation particulars (where appropriate), (*e*) delivery records, and (*f*) the firm's own certificate of registration. It will also be found advisable to compile a summary of the tax chargeable on each class of goods sold, for reference when invoices are being prepared or quotations given.

NOMINAL LEDGER ENTRIES.—The Commissioners recommend that "the additional records referred to" (under "Sales" above) "should be totalled monthly or quarterly as may be convenient and summarised in a separate Purchase Tax Account." Taken in conjunction with the prescribed form of return this recommendation appears to require the following type of account in the Nominal Ledger:—

PURCHASE TAX ACCOUNT

Dr. *Period* 1 (21*st October* 1940 *to* 31*st December* 1940) *Cr.*

	£		£
To Amount to be carried forward in respect of tax on goods not yet paid for (total of tax included in Sales Ledger balances) *c/d*		By Tax on Sales of chargeable goods delivered during the period (total of tax column in Sales Day Book)	
„ Balance, being tax now payable to Commis-missioners (to be agreed with tax column in Cash Book) . . .		*Deduct* Tax on returns and credits (total of tax column in Returns Inwards Book) . .	
	£		£

Dr. *Each Subsequent Period* *Cr.*

Dr.	£	Cr.	£
To Amount to be carried forward to next period (being tax on goods sold in the period but not yet paid for) *c/d* . .		By Amount brought forward from last period (being tax on sales not yet paid for) *b/d* . . .	
„ Balance, being tax now payable to the Commissioners :—		„ Tax on Sales of chargeable goods delivered during this period (from Sales Day Book) . . .	
(*a*) In respect of previous period . . .		*Deduct*—	
(*b*) In respect of sales during this period		(*a*) Tax on returns and credits in this period	
		(*b*) Tax on bad debts of previous period .	
	£		£

The complexities of this account will be better appreciated if it is remembered that there is an option to carry forward in each period the tax on goods for which payment has not been received. The amount of the tax not carried forward will, however, be payable in the next period irrespective of whether or not the goods have been paid for, subject to any allowed abatement for bad debts. Unless, however, the bad debt has been proved by the end of the period following that in which the goods were delivered, tax must be paid in full and any abatement subsequently allowable will be by way of refund or deduction from subsequent returns.

An account of the type suggested above presents no difficulties in the first period of the tax. Subsequently, however, there will be many complications if the balance brought down is not kept in exact agreement with the tax portion of the Sales Ledger balances. Thus it is advisable, as previously suggested, to provide a separate tax column in the Sales Ledger.

Whatever method of accounting is adopted for recording Purchase Tax, the desired results must be borne in mind, viz. :—

(1) That the tax payable to the Commissioners of Customs and Excise can be readily ascertained when it becomes due ; and

(2) That the Balance Sheet item for debtors does not include any amounts collectable, not on behalf of the business, but for the account of the Commissioners.

ANSWERS TO EXERCISES

Exercise 1.

D. Trial Balance: £1,232 14s. 8d. **E.** Trial Balance: £747 13s. **F.** Trial Balance: £1,144 8s. 6d. **G.** Trial Balance: £741 5s. **H.** Trial Balance: £1,829.

Exercise 2.

A. Capital: £741 14s. 9d. **B.** Capital: £2,275 12s. 2d. **C.** Capital: £2,965. **D.** Journal Total: £25,000. **E.** Sales Book: £604 3s. 7d.; Purchases Book: £1,008 15s. **F.** Sales Book: £103 12s. 1d.; Purchases Book: £113 9s. 8d.; Returns: £10 10s. **G.** Purchases Book: £45 0s. 6d. **H.** Sales Book: £493 19s.; **I.** Sales Book: £108; Purchases Book: £562 2s. 6d, **J.** Sales Book: £83 2s.; Purchases Book: £45 12s. 11d.; Returns: £1 1s. **K.** Sales Book: £538 17s.

Exercise 3.

A. Cash Balance: £425 8s. 5d.; Petty Cash Balance: £5 0s. 1d. **B.** Cash Balance: £107 4s.; Petty Cash Balance: £9 6s. 10d. **C.** Bank Balance: £675 5s. 8d.; Office Cash: £7 17s. 8d. **D.** Bank Balance: £3,370 11s. 6d. **E.** Bank Balance: £1,107 2s. 1d.; Office Cash: £5 0s. 8d. **F.** Bank Balance: £178 14s. 6d.; Office Cash: £45 7s. **G.** Cash Book: £1,014 10s. (credit); Capital Account: £11,177 10s.; Trial Balance: £15,617. **H.** Pass Book Balance: £1,550. **L.** Cheque obtained: £37 15s. 5d.

Exercise 4.

B. Balance—A. Co.: £8,781 13s. 9d. **E.** Depreciation: £672. **F.** Depreciation: £1,060. **G.** Balance—Plant Account: £5,262 10s. **H.** Gross Profit: £42,161; Net Profit: £26,364; Balance Sheet: £149,764. **I.** Gross Profit: £783; Net Profit: £277; Balance Sheet: £1,605. **J.** Net Profit: £1,646; Balance Sheet: £3,722. **K.** Gross Profit: £5,109; Net Profit: £1,391 10s.; Balance Sheet: £11,446 10s. **L.** Gross Profit: £13,599; Net Profit: £8,370; Balance Sheet: £47,004. **M.** Gross Profit: £7,583; Net Profit: £3,551; Balance Sheet: £21,165. **N.** Gross Profit: £1,647 15s. 6d.; Net Profit: £296 15s.; Balance Sheet: £2,097 7s. 1d. **O.** Bad Debts Reserve, 1940: £1,125; 1941: £950 11s.

Exercise 5.

N. New Bill: £357. **O.** £97 10s. **P.** *Dr.* Balance—*A*: £3,553 0s. 3d. **Q.** *Cr.*: £1 4s. 3d. **R.** Bad Debts: £75 13s. 2d.; Cash Book Balance: £424 11s. 9d. **S.** Balance: £427 4s. 2d. **T.** Balance: £356 5s.

Exercise 6.

D. *A*: £965 2s. 10d.; *B*: £411; *C*: £723 17s. 2d. **E.** *Cr.* Balances—Blundell: £1,141 2s. 6d.; Dent: £88 17s. 6d. **F.** Jordan: £815; Slater: £716 5s. **I.** Capital Accounts—*P*: £9,200; *Q*: £6,900; *R*: £4,000. **J.** H. Chance: £10,680; P. Chance: £5,760; D. Moss: £1,890. **K.** Gauley: £17,840; Forest: £8,920; Pirrie: £6,690. **L.** *X*: £10,000; *Y*: £5,000; *Z*: £3,000. **M.** Hunt: £3,658 2s. 6d.; Fox: £2,438 15s.; Barlow: £2,438 15s.; Blaize must introduce £1,219 7s. 6d. **N.** Ball: £7,810; Green: £5,262; Lane: £2,428. If salaries are drawn in cash these amounts are correspondingly reduced. **O.** Thorley: £9,000; Rutter: £5,000; Ashley: £7,000. **P.** (*a*) *A*: one-half; *B*: one-third; *C*: one-sixth. (*b*) *A*: $\frac{33}{65}$ths; *B*: $\frac{22}{65}$ths; *C*: $\frac{10}{65}$ths. **Q.** *A*: £25,095 ·

B: £24,100; *C*: *Nil*; Balance Sheet: £88,305. **R.** Henson's Executors: £10,672; Scanlan Capital Account: £8,710; Current Account: £852. **S.** Balance Sheet: £10,625; *R's* Executrix: £5,330. **T.** Net Increase: £1,400.

Exercise 7.

M. Original difference £19. Profit reduced by £64. **N.** Gross Profit: £1,584; Net Profit: £588 5s.; Divisible Profit: £522 7s.; Balance Sheet: £6,324 5s. **O.** Divisible Profit: £7.600; Balance Sheet: £41,900. **P.** Gross Profit: £15,300; Net Profit: £6,328; Divisible Profit: £4,928; Balance Sheet: £44,012. **Q.** Gross Profit: £3,846 18s. 2d.; Net Profit: £2,423 2s. 6d.; Divisible Profit: £2,291 12s. 5d.; Balance Sheet: £7,514 12s. 6d. **R.** Gross Profit: £3,320; Net Profit: £1,048; Divisible Profit: £716; Balance Sheet: £9,376. **S.** Gross Profit: £5,950; Net Profit: £3,785; Divisible Profit: £2,725; Balance Sheet: £7,780. **T.** Gross Profit: £8,528; Net Profit: £2,870; Divisible Profit: £2,114; Balance Sheet: £21,656. **U.** Cost of Production: £33,800; Gross Profit: £10,710; Net Profit: £7,190. **V.** Suspense Account: £185 4s.; Gross Profit: £5,662 4s.; Net Profit: £2,799 12s.; Balance Sheet: £14,279 12s. **W.** Commencing Capital (*i.e.* Difference on Trial Balance): £16,995; Gross Profit: £8,280; Net Profit: £1,220; Balance Sheet: £34,430. **X.** Gross Profit: £12,871; Net Profit: 7,262; Balance Sheet: £50,106.

Exercise 8.

E. Cash Balance: £18,762. **F.** Cash Balance: £18,830. **G.** Forfeited Shares Balance: £500. **H.** Forfeited Shares Balance: £300. **I.** Debentures: £10,000; Debenture Discount Balance: £475. **K.** Premiums on Shares: £32,500 transferred to Capital Reserve. **L.** Interest: £8,000. **M.** Forfeited Shares Balance: £1,375. **N.** Total Cash: £130,000. **O.** (*a*) Realisation Account: £250,000; (*b*) Total Assets: £250,000. **P.** Cash Balance: £37,500; Share Capital: £37,500. **Q.** Purchase Price: £30,000. **R.** Profit on Realisation: £3,000; Purchase Price: £47,000. **S.** Share Capital: £300,000; Premium: £75,000. **T.** Cash Balance: £50,000; Capital: £150,000. **U.** Allotment; Amount payable: £47,500; returnable: £2,500. **V.** Preference Share Capital: £150,000; Ordinary: £199,500; Cash Balance: £60,000; Balance Sheet: £512,000.

Exercise 9.

F. Appropriation Account Balance: £1,713 17s. 2d. **G.** Gross Dividend: £2,574, Tax: £1,287; Net: £1,287. **J.** Pre-incorporation profits—Turnover: £2,083 6s. 8d.; Time: £1,875. **L.** Bonus: £8,000; Profit and Loss Balance: £2,876 15s. 2d. **M.** Bonus absorbs £50,000. **N.** Total Capital: £170,000; Reserve Balance: £40,000; Profit and Loss: £10,000. **O.** Balance Capital: £5,400; Reserve: £14,400; Profit and Loss: £12,200. **P.** Revised Balance Sheet: £2,792,135. **Q.** Reduction: £25,000. **R.** Purchase Price: £107,600. **S.** Gross Profit: £4,645; Net Profit: £880 19s.; Balance Sheet: £19,145. **T.** Gross Profit: £3,734; Net Loss: £783; Profit and Loss—*Dr.*: £1,054; Balance Sheet: £46,681. **U.** Gross Profit: £752; Net Loss: £2,921 6s.; Balance Sheet: £33,800. **V.** Gross Profit: £27,582; Net Profit: £4.444; Balance Sheet: £51,344 10s. **W.** Gross Profit: £29,312; Net Profit: £3,333; Balance Sheet: £65,533. **X.** Net Profit: £23,275; Divisible Profit: £14,275; Balance Sheet: £1,052,775. **Y.** Balance Sheet: £300,550. **Z.** Balance Sheet: £242,540; Minority Interests, £6,000. **AA.** Balance Sheet: £305,700 (after deducting Capital Reserve, £2,400, from excess of cost of shares over nominal value); Minority Interests: Round Tyre Co., Ltd., £7,160; Everlasting Engine Co., Ltd., £2,260. **BB.** Phoenix, Ltd., Loss on Realisation, £15,000; Excelsior, Ltd., Capital Reserve, £5,500. **CC.** Capital Reserve, £2,000; Balance Sheet, £42,000. **DD.** Goodwill, £12,000. **EE.** Purchase Consideration, £6,125; Loss on Realisation, £875.

Exercise 10.

A. Account Sales, Net: £2,729 8s. 6d.; Profit: £710 9s. 6d.; Alden—*Dr.* Balance: £1,729 8s. 6d. **B.** Account Sales, Net: £846 11s. 9d. **D.** Net Profit: £103. **E.** Net Profit: £244 2s. 6d.; Samos—*Dr.* Balance: £509 1s. 6d. **F.** Net Profit, First portion: £127; Second portion: £22. **G.** *Dr.* Balance: £361 10s. 6d. **H.** Interest to debit: £6 11s. 4d.; Final payment: £292 11s. 4d **K.** 15th September: £27 17s. **L.** 10th April: £8,526.

Exercise 11.

C. Balance: £13,740. **D.** Net Balance: £576 19s. 10d.; Trial Balance: £576 19s. 10d. **F.** Sales Ledger Balances: £131 5s.; Purchases Ledger Balances: £150. **G.** Gross Profit: A, £4,459; B, £3,100; C, £2.518; Total: £10,077; Percentage: A, 39·9%; B, 55·23%; C, 51·91%; Total: 46·57%. Net Profit: A, £323; B, £636; C, £712; Total: £1,671; Percentage: A, 2·89%; B, 11·33%; C, 14·68%; Total: 7·72%. **H.** Gross Profit: Fleet Street, £4,181; Clerkenwell, £5,482; Net Profit: Fleet Street, £1,820; Clerkenwell, £1,088; Balance Sheet: £17,224. **I.** Gross Profit: A, £9,400; B, £3,000; Total: £12,400; Net Profit: A, £7,550; B, £1,350; Total: £8,900. After charging interest and tax: £3,310; Balance Sheet: £47,000. **J.** Gross Profit: 1, £5,000; 2, £2,500; 3, £750; 4, £1,500; 5, £4,000; Total: £13,750. Net Profit: 1, £3,550; 2, £1,630; 3, £460; 4, £746; 5, £3,014; Total: £9,400; Percentage: 1, 14·79%; 2, 15·52%; 3, 9·68%; 4, 6·49%; 5, 20·09%; Total: 14·30%.

Exercise 12.

A. Head Office Balance: £3,460. **B.** Barnsley Branch Account Balance: £382 16s. 10d. (closing stock). Profit: £549 14s. 9d. **D.** Net Profit: £1,033; Balance of Branch Account: £2,331. **I.** Gross Profit: Head Office, £31,458; A, £16,144; B, £6,583. Net Profit: Head Office, £26,740; A, £11,609 10s.; B, £3,260 15s.; Divisible Profit: £28,784 5s.; Balance Sheet: £131,119 5s. **L.** Profit on Exchange: £13 0s. 5d. **M.** Balance Sheet: New York, £85,208 6s. 8d.; Manchester: £89,500; London: £255,500; Combined £255,458 6s. 8d. (adjustment accounts omitted). **N.** Loss on Realisation: £708 5s. 2d.; Loss on Exchange: £202 14s. 11d.; Profit and Loss Account Balance: £2,588 19s. 11d.; Balance Sheet: £47,588 19s. 11d. **P.** Profit on Exchange, £2 5s. 8d.

Exercise 13.

A. Manager's Commission, £38 2s. 5d.; Net Profit: £762 7s. 7d. **E.** Cash Balance: £315 10s.; Income and Expenditure: £298; Balance Sheet: £1,315 10s. **I.** First year: Minimum Rent, £4,000; Second year: Royalties, £4,000; Third year: £6,250. **J.** Short Workings: First year, £437 10s.; Second year, £425; Third year, £250; Fourth year, Recouped, £600; Irrecoverable; £512 10s. **K.** Short Workings: 1938, £150; Recouped, 1939, £25; 1940, £75; Irrecoverable, £50. **O.** Interest: 1938, £5 1s. 1d.; 1939, £3 9s. 4d.; 1940, £1 15s. 9d.; Final instalment, £31 11s. 2d. **Q.** Net Profit: £6,064; Manager's Commission on profits: £303 4s.; Divisible: £4,260 16s.; Per share: £66 11s. 6d. **R.** Net Income: £375; Profit on Sale: £153 6s. 6d. **S.** Final Profit on Policy: £120. **T.** First settlement, amount payable: £95 9s. 10d.; Second settlement, amount receivable: £112 6s. **U.** Estimated Gross Profit: £44,800; Amount of Claim: £21,400. **V.** Cash Book, Solicitors' Account: £10 (debit balance); Green's Account: £10 (debit balance).

Exercise 14.

B. Net Profit: £385; Statement of Affairs: £4,565. **C.** Net Profit: £1,845. **D.** Net Profit: £429; Balance Sheet: £4,911. **E.** Net Profit: £615; Statement of Affairs: £3,815. **F.** Divisible Profit: £2,421; Roy: £1,008 15s.; Teece: £807; Earl: £605 5s.; Statement of Affairs: £10,836.

Exercise 15.

A. Loss, *A* and *B*, £1,568 10s. each; Cash distributed: *A*, £2,431 10s.; *B*, £431 10s. **B.** Loss: James, £4,400; Pratt, £2,200; James pays in £200; Cash distributed: James, Loan, £6,000; Pratt, Capital, £2,300; **C.** Loss: *A*, £3,392 1s. 8d.; *B*, £1,453 15s.; *C*, £969 3s. 4d.; Cash distributed: *A*, £4,295 8s. 4d.; *B*, £3,671 5s.; *C*, £1,593 6s. 8d. **D.** Loss: Oldfield and Young, £200 each; Young pays £1,300 to Oldfield. **E.** Profit: Brown, £522 10s.; Davis, £522 10s.; Davis pays £137 10s. to Brown. **F.** Loss: Locke and Edwards, £930 each; Cash distributed: Locke, £2,570; Edwards, £1,445. **G.** Profit: Francis and Clifford: £596 4s. each; Cash distributed: Clifford, Loan, £1,000; Capital, £3,596 4s.; Francis, Capital, £4,596 4s. **H.** Loss: Crake, Sheen and Wells, £380 each; Cash distributed: Sheen and Wells, £455 each. **I.** Statement of Affairs: £5,465; Deficiency, £1,837. **J.** Statement of Affairs: £8,264; Deficiency, £3,808; Dividends: 10s. 9¼d. **K.** Statement of Affairs: £24,200; Deficiency, £18,500. **L.** Statement of Affairs: £4,430; Deficiency, £1,180. **M.** Statement of Affairs: £19,660; Deficiency, £9,820 **N.** Surplus as regards creditors: £11,192; shareholders: £3,192. **O.** Dividend to creditors at 12s. 8½d. in £ absorbs £6,465 7s. **P.** Creditors paid in full; dividend to shareholders at 14s. in £ absorbs £2,800. **Q.** Preference Shareholders, 25s. per share; Ordinary Shareholders, 25s. per share; Deferred Shareholders (4,000), 5s. per share.

Exercise 16.

P. Cost of Materials, £25,600 (including carriage); Value of Output, £65,600; Cost of Sales, £66,600; Percentage of Gross Profit to Sales, 20·71. **T.** Total Cost, £96,400; Per ton, £3 0s. 3d. **U.** Prime Cost, £310,000; Works Cost, £347,125; Total Cost, £370,375; Works Overhead Charges, 27·5 per cent. on Manual and Machine Labour Wages; Establishment and General Expenses, 6·69 per cent. on Works Cost; Estimated Cost of Machine, £1,616; Selling Price, £2,020. **V.** Factory Process: Cost, Black, £14,000, per gross, 11s. 8d.; Coloured, £4,725, per gross, 11s. 3d.: Finishing Process: Cost, Black, £6,000, per gross, 5s.; Coloured, £1,680, per gross, 4s. Oncost, Black, £2,700, per gross, 2s. 3d.; Coloured, £945, per gross, 2s. 3d.; Total Cost: Black, £22,700, per gross, 18s. 11d.; Coloured, £7,350, per gross, 17s. 6d. **W.** Prime Cost: A, £11,325; B, £6,450; C, £2,725; Total, £20,500. Oncost: A, £4,041; B, £2,455; C, £793; Total, £7,289; Total Cost: A, £15,366; B, £8,905; C, £3,518; Total, £27,789; Machine Hours: A, 12,480; B, 8,320; C, 2,080; Total, 22,880; Per hour: A, 6s. 5·71d.; B, 5s. 10·81d.; C, 7s. 7·50d. Total: 6s. 4·46d. **X.** Manufacturing Account (credit balance): £11,030. **Y.** Total Profit, £6,500; Divisible Profit, £3,466 13s. 4d.

Exercise 17.

D. Capital Account: Total, £260,000. **E.** Revenue Account: Balance, £67,435; Net Revenue, £23,500; Capital, £36,000; Balance Sheet, £91,500. **G.** Balance Sheet: £418,148,605 17s. 6d. **J.** (1) Single Account Balance Sheet, £372,000; (2) Capital Account, £40,000 (credit); General Balance Sheet, £112,000. **K.** Balance Sheet, £1,499,256.

Exercise 18.

A. Revenue Accounts Balances: Fire, £10,380 1s. 6d.; Accident, £780 6s. 10d; Employers' Liability, £27,340 5s. 3d.; General, £99,668 3s. 5d.; Profit and Loss Balance, £71,171 9s. 2d.; Balance Sheet, £655,803 1s. 5d. **E.** Trial Balance, £6,035,071; Revenue Balance, £4,618,476; Balance Sheet, £5,618,504. **I.** Profit and Loss Account, £37,350; Balance Sheet, £1,288,870.

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